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Beyond Preemption: Accommodation of the Nonemployee Spouse's Interest Under ERISA

By DEENE GOODLAW SOLOMON*

Retirement benefits earned by an employee during marriage may be one of the most substantial assets accumulated by the couple. If a marriage ends in divorce, those benefits play a significant role in marital property arrangements made under state law. Traditionally, retirement benefits are treated as income to the employee spouse and therefore are included in the measure of his or her ability to furnish continued support to dependents in the form of alimony and child support.¹

A growing number of jurisdictions are recognizing that retirement benefits are more than a measure of capacity to pay alimony. Increasingly, retirement benefits are being treated as property² that is an asset of the marital community and which, like other marital property, should be divided between the spouses upon dissolution of the marriage. The right of the nonemployee spouse to share in retirement benefits earned during marriage as a co-earner of those benefits, not merely as a needy dependent, has been most fully recognized in community

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1. See, e.g., *In re Marriage of Ellis*, 36 Colo. App. 234, 538 P.2d 1347, *aff'd*, 191 Colo. 317, 552 P.2d 506 (1975); *Howard v. Howard*, 196 Neb. 351, 242 N.W.2d 884 (1976). For cases upholding the collection of spousal support awards from retirement plans covered by the Employment Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified at 29 U.S.C. §§ 1001-1381 (1976)), see *Cody v. Riecker*, 594 F.2d 314 (2d Cir. 1979); *American Tel. & Tel. Co. v. Merry*, 592 F.2d 118 (2d Cir. 1979). The Tax Division of the Justice Department filed *amicus curiae* briefs for the Secretaries of Labor and the Treasury in both cases, supporting the position of the nonemployee spouse.

2. See P. DRUCKER, *THE UNSEEN REVOLUTION: HOW PENSION FUND SOCIALISM CAME TO AMERICA* 149 (1976).

property jurisdictions.³ Community property law generally treats both

3. The law determining the rights and interests of the nonemployee spouse has been most fully developed in California. See Reppy, *Community and Separate Interests in Pensions and Social Security Benefits After Marriage of Brown and ERISA*, 25 U.C.L.A.L. REV. 417, 417-29 (1978) [hereinafter cited as Reppy]. Even in California, the rights of the nonemployee spouse are significantly more limited than those of the employee. There is a line of cases, particularly those involving public retirement plans (which would not be covered by ERISA, see 29 U.S.C. § 1003(b) (1976)), which in some circumstances limited a nonemployee spouse's right to collect his or her interest from the plan by providing that such a right terminates on the death of the employee or the nonemployee, whichever occurs first. This so-called "terminable interest rule" has been upheld in *Waite v. Waite*, 6 Cal. 3d 461, 473, 492 P.2d 13, 21, 99 Cal. Rptr. 325, 333 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976), and *Benson v. Los Angeles*, 60 Cal. 2d 355, 360-62, 384 P.2d 649, 652-53, 33 Cal. Rptr. 257, 260-61 (1963). This rule apparently does not preclude a court from considering the relative life expectancies of the spouses and the actuarial value of their respective pension benefits under the plan when dividing the total community property. See *Waite v. Waite*, 6 Cal. 3d at 473 n.8, 474 n.9, 492 P.2d at 21, 22, 99 Cal. Rptr. at 333, 334; *Benson v. Los Angeles*, 60 Cal. 2d at 361-62, 384 P.2d at 652-53, 33 Cal. Rptr. at 260-61. The rule has been seriously criticized by commentators, see, e.g., Reppy, *supra*, at 462-82, and by the courts, see e.g., *In re Marriage of Peterson*, 41 Cal. App. 3d 642, 654-56, 115 Cal. Rptr. 184, 192-94 (1974), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976). The terminable interest rule does not apply to contributions made by an employee during marriage. They are included in the community property and divided between the spouses without regard to their life expectancies. *Phillipson v. Board of Administration*, 3 Cal. 3d 32, 41 n.8, 473 P.2d 765, 770, 89 Cal. Rptr. 61, 66 (1970), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976). One court has applied the rule to a private pension plan, see *In re Marriage of Bruegl*, 47 Cal. App. 3d 201, 120 Cal. Rptr. 597 (1975), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976). The relationship of the terminable interest rule to the spouse's interest in ERISA is discussed further at notes 151-96 & accompanying text *infra*.

The nonemployee spouse's interest in the benefits is further limited by the employee's freedom to change employment, which may result in forfeiture of nonvested benefits, including the nonemployee spouse's interest therein. Apart from constitutional problems, one could hardly expect a court to require an employee to continue in service until benefits vest. Somewhat surprisingly, however, in California the employee also retains the exclusive right to modify terms of employment or elect between alternative retirement programs. *In re Marriage of Brown*, 15 Cal. 3d 838, 849, 544 P.2d 561, 568, 126 Cal. Rptr. 633, 640 (1976). The employee thus retains the sole right to define the nature of the retirement benefits owned by the community. *Id.* at 850, 544 P.2d at 568, 126 Cal. Rptr. at 640. Earlier cases permitted a court to order an employee to make an election that fully preserved the nonemployee spouse's interest, if no election had been made at the time of dissolution. *Phillipson v. Board of Administration*, 3 Cal. 3d 32, 48, 473 P.2d 765, 775, 89 Cal. Rptr. 61, 71 (1970), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Ball v. McDonnell Douglas Corp.*, 30 Cal. App. 3d 624, 630, 106 Cal. Rptr. 662, 665 (1973) (dictum). The Supreme Court in *In re Marriage of Brown*, 15 Cal. 3d 838, 544 P.2d 561, 126 Cal. Rptr. 633 (1976), however, restricted *Phillipson* to its facts, which were unique in that the employee spouse had absconded with most of the community assets. The trial court, to equalize the division of community property, awarded the nonemployee spouse the entire retirement benefit. *Id.* at 849 n.12, 544 P.2d at

spouses as co-owners of the benefits, with equal rights to enjoy them as of the time they are earned.⁴ Community property jurisdictions also generally include these benefits in the community property to be divided on divorce. An increasing number of noncommunity states also seek to divide the marital property equitably between spouses on divorce,⁵ particularly states that have adopted the Uniform Marriage and Divorce Act, which authorizes such a division.⁶ In those jurisdictions, when retirement benefits are divided in the divorce, the nonemployee spouse becomes a co-owner of the benefits at the time of divorce. Each spouse's interest is then defined and discreet, not subject to modification as a result of changed financial circumstances, remarriage, or, pos-

568, 126 Cal. Rptr. at 640. If the plan has not been joined under CAL. CIV. CODE §§ 4363.1 to 4364 (West Supp. 1980), it need only deal with the employee without consultation or approval of the nonemployee spouse. See *Ball v. McDonnell Douglas Corp.*, 30 Cal. App. 3d 624, 629, 106 Cal. Rptr. 662, 665 (1973). Retirement benefits thus seem to fall under the "business interest" exception to the joint management and control usually exercised by both parties in California over community property. See CAL. CIV. CODE § 5125(d) (West Supp. 1980). For a brief discussion of disability benefits paid after separation see note 50 *infra*.

4. See, e.g., *Van Loan v. Van Loan*, 116 Ariz. 272, 569 P.2d 214 (1977); *In re Marriage of Brown*, 15 Cal. 3d 838, 544 P.2d 561, 126 Cal. Rptr. 633 (1976); *Due v. Due*, 342 So. 2d 161 (La. 1977); *T.L. James & Co. v. Montgomery*, 332 So. 2d 834 (La. 1976); *Ellett v. Ellett*, 573 P.2d 1179 (Nev. 1978); *Le Clert v. Le Clert*, 80 N.M. 235, 453 P.2d 755 (1969); *Cearley v. Cearley*, 544 S.W.2d 661 (Tex. 1976). See also *Fink & Victor, Slicing the Pension Pie: Tax Problems Involved in Spousal Division of Unmatured Pension Benefits*, 49 L.A.B. BULL. 186 (1974); *Hardie, Pay Now or Later: Alternatives in the Disposition of Retirement Benefits on Divorce*, 53 CAL. ST. B.J. 106 (1978); *Reppy, supra* note 3; *Thiede, The Community Property Interest of the Non-Employee Spouse in Private Employee Retirement Benefits*, 9 U.S.F.L. REV. 635 (1975) [hereinafter cited as *Thiede*]; *Comment, Retirement Benefits and the Right to Reimbursement*, 11 HOUS. L. REV. 960 (1974); *Note, In Re Marriage of Brown: Every Family Lawyer Knows What It's Done—Do You Know What It Can Do?*, 4 PEPPERDINE L. REV. 147 (1976); *Comment, Apportionment of Community Property Interests in Prospective Military Retirement Benefits upon Divorce*, 9 ST. MARY'S L.J. 72 (1972); *Comment, The Wife's Community Interest in Her Husband's Qualified Pension or Profit Sharing Plan*, 50 TEX. L. REV. 334 (1972); *Note, Pension Rights and Community Property: From French to Brown*, 4 W. ST. U.L. REV. 91 (1976); 9 ST. MARY'S L.J. 135 (1977); 8 TEX. TECH. L. REV. 834 (1977).

5. *In re Marriage of Pope*, 37 Colo. App. 237, 544 P.2d 639 (1975); *In re Marriage of Powers*, 527 S.W.2d 949 (Mo. Ct. App. 1975), noted in 42 Mo. L. REV. 143 (1977); *McGrew v. McGrew*, 151 N.J. Super. 515, 377 A.2d 697 (1977); *Blitt v. Blitt*, 139 N.J. Super. 213, 353 A.2d 144 (1976); *Pellegrino v. Pellegrino*, 134 N.J. Super. 512, 342 A.2d 226 (1975); *Johnson v. Johnson*, 78 Wis. 2d 137, 254 N.W.2d 198 (1977); *Pinkowski v. Pinkowski*, 67 Wis. 2d 176, 226 N.W.2d 518 (1975). See also *Foster & Freed, Spousal Rights in Retirement and Pension Benefits*, 16 J. FAM. L. 187 (1978); *Krauskopf, Marital Property at Marriage Dissolution*, 43 Mo. L. REV. 157, 171-76 (1978); *Note, Pensions As Property Subject To Equitable Division upon Divorce in Oklahoma*, 14 TULSA L.J. 168 (1978). See generally *Prager, Sharing Principles and the Future of Marital Property Law*, 25 U.C.L.A.L. REV. 1 (1977). But see *Fenny v. Fenny*, 259 Ark. 858, 537 S.W.2d 367 (1976) (refusing to consider pension as part of marital property); *Howard v. Howard*, 196 Neb. 351, 242 N.W.2d 884 (1976) (same).

6. See UNIFORM MARRIAGE AND DIVORCE ACT § 307. The Act has been adopted in Colorado, Kentucky, Maine, Missouri, and Illinois.

sibly,⁷ the death of either spouse.

In dividing retirement plan benefits upon divorce, many states, both community and noncommunity, have distinguished between retirement benefits that are vested at the time of divorce and those that are nonvested.⁸ Retirement benefits that accrue during the employee's years of service as a participant in a retirement plan are vested only when an employee is entitled to receive those benefits without additional service as an employee.⁹ Vested benefits are not necessarily currently payable. For example, benefits earned by a thirty-five year old employee with ten years of service may be fully vested, although not payable before he or she reaches age sixty-five.

Under state law, the preferred method of disposing of retirement benefits in a dissolution proceeding is to award the benefits entirely to the employee spouse with property of equivalent value being awarded to the nonemployee spouse.¹⁰ This method fosters a clean break between the parties, gives the benefits to the spouse from whose employment they derive, and does not interfere with the administration of the retirement plan because the administrator will need to deal only with the employee.

If the retirement benefits comprise a substantial portion of the marital property, however, it may not be possible to award them entirely to the employee spouse. In that case, they may be divided between the spouses at the time of divorce, even though not currently payable from the plan. If the benefits are not susceptible of valuation, or if they are nonvested, a court may retain jurisdiction until such time as the benefits are payable and award each spouse a portion of the benefits as paid, based on the ratio of the length of the marriage to the

7. The question of whether the nonemployee spouse's interest is modifiable by the death of either spouse is uncertain. See note 3 *supra*.

8. Compare *In re Marriage of Ellis*, 36 Colo. App. 234, 538 P.2d 1347, *aff'd*, 191 Colo. 317, 552 P.2d 506 (1975); *Robbins v. Robbins*, 463 S.W.2d 876 (Mo. 1971); and *White v. White*, 136 N.J. Super. 552, 347 A.2d 360 (1975) (nonvested benefits were not considered to be part of marital property) with *In re Marriage of Pope*, 37 Colo. App. 237, 544 P.2d 639 (1975), and *Penkowski v. Penkowski*, 67 Wis. 2d 176, 226 N.W.2d 518 (1975) (vested benefits held to be part of marital property).

9. ERISA establishes minimum vesting standards for determining forfeitability of pension rights. See 29 U.S.C. § 1053 (1976); I.R.C. § 411.

10. See, e.g., *Phillipson v. Board of Administration*, 3 Cal. 3d 32, 46, 473 P.2d 765, 774, 89 Cal. Rptr. 61, 70 (1970), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976). See also *Marriage of Marx*, 97 Cal. App. 3d 552, 559-60 (1979) (husband objected for tax reasons to being awarded entire fund; court nonetheless found a "strong economic situation" warranting award to wife of home and award to husband of fund).

length of total employment.¹¹

The treatment of retirement plan benefits by state courts cannot be discussed or analyzed adequately without reference to federal regulatory legislation. All privately funded deferred benefit plans engaged in interstate commerce are subject to Title I of the Employment Retirement Income Security Act of 1974¹² (ERISA). Section 514 of ERISA supersedes all state laws relating to employee benefit plans.¹³ Whether and to what extent section 514 preempts state marital property laws has been a troublesome issue which has prompted much litigation¹⁴ and

11. See *In re Marriage of Brown*, 15 Cal. 3d 838, 848, 544 P.2d 561, 567, 126 Cal. Rptr. 633, 639 (1976). This method of determining the marital property interest of a retirement benefit earned partly during the marriage and partly before and/or after is known as the "time rule method" and is used unless it does not approximate the respective marital and nonmarital property interest. It has been most clearly developed in California. *In re Marriage of Judd*, 68 Cal. App. 3d 515, 522, 137 Cal. Rptr. 318, 321 (1977); *In re Marriage of Adams*, 64 Cal. App. 3d 181, 186, 187 n.8, 134 Cal. Rptr. 298, 302 (1976); *In re Marriage of Freiberg*, 57 Cal. App. 3d 304, 311, 127 Cal. Rptr. 792, 797 (1976); *In re Marriage of Martin*, 50 Cal. App. 3d 581, 583, 123 Cal. Rptr. 634, 634 (1975), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976). For more detailed discussions of the time rule method. see LeVan, *Allocating Deferred Compensation in Louisiana*, 38 LA. L. REV. 35 (1979); McNamara, *California Community Property Aspects of Executive Compensation*, U.S. CAL. 1978 TAX INST. 151, 158; Comment, *Appointment of Community Property Interests in Prospective Military Retirement Benefits upon Divorce*, 9 ST. MARY'S L. REV. (1977).

12. Employment Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1381 (1976).

13. Section 514(a) of ERISA provides: "Except as provided in subsection (b) of this section, the provisions of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereinafter relate to any employee benefit plan described in section 1003(a) of this title and not exempt under section 1003(b) of this title. This section shall take effect on January 1, 1975." 29 U.S.C. § 1144(a) (1976). Under subsection (b) of § 514, it is stated: "(1) This section shall not apply with respect to any cause of action which arose, or any act or omission which occurred, before January 1, 1975.

"(2)(A) Except as provided in subparagraph (B), nothing in this subchapter shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities.

"(B) Neither an employee benefit plan described in section 1003(a) of this title, which is not exempt under section 1003(b) of this title (other than a plan established primarily for the purpose of providing death benefits), nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, bank, trust company, or investment company or to be engaged in the business of insurance or banking for purposes of any law of any State purporting to regulate insurance companies, insurance contracts, banks, trust companies, or investment companies.

"(3) Nothing in this section shall be construed to prohibit use by the Secretary of services or facilities of a State agency as permitted under section 1136 of this title.

"(4) Subsection (a) of this section shall not apply to any generally applicable criminal law of a State." 29 U.S.C. § 1144(b) (1976).

14. See, e.g., *Cody v. Riecker*, 594 F.2d 314 (2d Cir. 1979); *American Tel. & Tel. Co. v. Merry*, 592 F.2d 118 (2d Cir. 1979); *Central States Southeast v. Parr*, No. 9-70184 (E.D.

commentary.¹⁵

The issue recently was resolved by the United States Supreme Court in favor of the state laws and against preemption. *Carpenter's Pension Fund v. Campa*¹⁶ came before the Court on appeal from a California state court decision. The case involved three nonemployee spouses, each of whom had been awarded a community property interest in the retirement benefits of their former husbands. The retirement fund was joined¹⁷ and ordered by the California court to pay the spouses a portion of each pension payment payable to their respective former husbands.¹⁸ The retirement fund appealed to the Supreme Court on the ground that ERISA precluded a state court from ordering payments directly from the fund. The Supreme Court dismissed the appeal for want of a substantial federal question, a decision on the merits¹⁹ and an action binding on all state and lower federal courts. Its value as precedent is unclear,²⁰ but the Court's action would appear to

Mich. Dec. 12, 1979); *Senco of Fla., Inc. v. Clark*, 473 F. Supp. 902 (M.D. Fla. 1979); *Francis v. United Technologies*, 458 F. Supp. 84 (N.D. Cal. 1978); *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978); *Carpenter's Pension Fund v. Campa*, 89 Cal. App. 3d 113, 152 Cal. Rptr. 362 (1979), *appeal dismissed for want of a substantial federal question*, 100 S.Ct. 696 (1980); *In re Marriage of Johnston*, 85 Cal. App. 3d 900, 149 Cal. Rptr. 798 (1978), *cert. denied*, 100 S. Ct. 709 (1980); *Johns v. Retirement Fund Trust*, 85 Cal. App. 3d 511, 149 Cal. Rptr. 551 (1978), *appeal dismissed for want of jurisdiction*, 100 S. Ct. 696 (1980).

15. See Dickinson, *Role of Retirement Plan*, 10 REAL PROP., PROB. & TR. J. 644 (1975); Hutchinson & Ifshin, *Federal Preemption of State Law under the Employee Retirement Income Security Act of 1974*, 46 U. CHI. L. REV. 23 (1978); Pattiz, *In a Divorce or Dissolution Who Gets the Pension Rights: Domestic Relations Law and Retirement Plans*, 5 PEPPERDINE L. REV. 191 (1978); Reppy, *supra* note 3 at 483-527; Thiede, *supra* note 4; Turza & Hal-loway, *Preemption of State Laws Under the Employee Retirement Income Security Act of 1974*, 28 CATH. U.L. REV. 163 (1979); Comment, *ERISA Preemption and Indirect Regulation of Employee Welfare Plans Through State Insurance Laws*, 78 COLUM. L. REV. 1536 (1978); Note, *Attachment of Pension Benefits Under ERISA*, 74 NW. U.L. REV. 255 (1979); Comment, *Preemption of California Community Property Law by ERISA: Congressional Intent and Judicial Interpretation*, 10 PAC. L.J. 881 (1979); Comment, *ERISA: Does it Prohibit a State Court from Attaching Plan Benefits?*, 40 U. PITT. L. REV. 47 (1978); Note, *ERISA Preemption or Divorce Decree Enforcement Against Pension Plans*, 1979 WIS. L. REV. 277.

16. 89 Cal. App. 3d 113, 152 Cal. Rptr. 362 (1979), *appeal dismissed for want of a substantial federal question*, 100 S. Ct. 696 (1980).

17. CAL. CIV. CODE § 4363.1 (West Supp. 1980) permits joinder of pension funds in marital dissolution proceedings.

18. 89 Cal. App. 3d 113, 152 Cal. Rptr. 362, 373 (1979).

19. *Hicks v. Miranda*, 422 U.S. 332, 343-45 (1975). When the Court concludes that the state court decision is correct, the appeal will be "dismissed for want of a substantial federal question." The dismissal is the equivalent of affirmance on the merits. R. STERN & E. GRESSMAN, *SUPREME COURT PRACTICE* ¶ 5.18, at 377-78 (5th ed. 1978).

20. The decision is binding on lower federal and state courts but is not precedent for the Supreme Court. See HART & WECHSLER'S *THE FEDERAL COURTS AND THE FEDERAL SYSTEM* 649 (2d ed. 1973).

render the preemption issue moot as to community property.

The Supreme Court's decision in *Campa* with respect to community property is in accord with the weight of authority permitting collection of alimony and child support directly from a plan.²¹ It also is in accord with the administrative position of the Internal Revenue Service that payment of court ordered support or community property interests directly from a plan will not result in disqualification of the plan under Internal Revenue Code section 401(a).²² Finally, the decision comports with the position expressed by the Department of Justice in its amicus curiae brief²³ filed in two cases addressing the preemption issue disposed of by the Court at the same time as *Campa*.²⁴ Moreover, Congress presently is considering legislation, in the form of Senate Bill 209, that would permit plans to pay support or marital property claims directly to the nonemployee spouse.²⁵

While the Supreme Court's decision in *Campa* appears correct, the mode of decision is disappointing. An issue as complex as ERISA preemption merits full review by the Court, including complete briefs, oral arguments, and a fully articulated opinion, especially in light of the Court's decision the prior term that the Railroad Retirement Act preempts community property statutes.²⁶ There is some speculation²⁷

21. *Cody v. Riecker*, 594 F.2d 314 (2d Cir. 1979); *American Tel. & Tel. Co. v. Merry*, 592 F.2d 118 (2d Cir. 1979); *Senco of Fla., Inc. v. Clark*, 473 F. Supp. 902 (M.D. Fla. 1979).

22. *E.g.*, Rev. Rul 80-27, 1980-4 I.R.B. at 8; Private Letter Ruling 7952045. *But see* Private Letter Ruling 8010051 (Dec. 12, 1979) (payment to the nonemployee spouse of vested benefits which are not currently payable will disqualify the plan).

23. 15 DAILY TAX REPORT (BNA) G-1 (January 22, 1980).

24. *In re Marriage of Johnston*, 85 Cal. App. 3d 900, 149 Cal. Rptr. 798 (1978), *cert. denied*, 100 S. Ct. 709 (1980); *Johns v. Retirement Fund Trust*, 85 Cal. App. 3d 511, 149 Cal. Rptr. 551, *appeal dismissed for want of jurisdiction*, 100 S. Ct. 696 (1980).

25. S. 209, 96th Cong., 1st Sess., 125 Cong. Rec. 555 (1979), has been passed by the United States Senate and is awaiting action by the House of Representatives. Section 128 of S. 209 provides: "Section 206(d) of such Act [ERISA] is amended by adding at the end thereof the following new paragraph:

"(3) Paragraph (1) shall not apply in the case of a judgment, decree or order (including an approval of a property settlement agreement), pursuant to a State domestic relations law (whether of the common law or community property type), which—

"(A) affects the marital property rights of any person in any benefit payable under a pension plan or the legal obligation of any person to provide child support or make alimony payments, and

"(B) does not require a pension plan to alter the effective date, timing, form, duration, or amount of any benefit payments under the plan or to honor any election which is not provided for under the plan or which is made by a person other than a participant or beneficiary."

26. *Hisquierdo v. Hisquierdo*, 439 U.S. 572 (1979). The Railroad Retirement Act, 45 U.S.C. §§ 231-231(t) (1976), differs from private plans covered by ERISA in several material aspects. First, it is statutory and may be altered or eliminated by Congress at any time.

that the Supreme Court is waiting to hear *Stone v. Stone*,²⁸ a case now pending in the Ninth Circuit. Nonetheless, postponement of a definitive decision does a great disservice to the courts, individuals, and plan administrators who must make decisions in the face of the present uncertainty. The state court in *Campa* relied heavily on the district court's opinion in *Stone*, whose facts are virtually indistinguishable from those in *Campa*.²⁹ The Supreme Court's decision undoubtedly will deter further litigation of the issue by plan administrators and participants.³⁰ A trustee of an employee benefit plan will be especially

Hisquierdo v. Hisquierdo, 439 U.S. at 575. By contrast, ERISA covers voluntary, consensual arrangements between employees or their bargaining units and employers. Second, the anti-assignment provisions of the Railroad Retirement Act expressly prohibit anticipation, garnishment, attachment, taxation or assignment of any annuity, 45 U.S.C. § 231m (1976), except for child or spousal support. See 45 U.S.C. § 231a(c)(3)(i) (1976); 42 U.S.C. § 659(a) (Supp. II 1978). This exception does not include community property or other marital property claims. 42 U.S.C. § 662(c) (Supp. II 1978). But see Pub. L. No. 95-366, 92 Stat. 600 (1978) (permitting payment of civil service retirement benefits to a former spouse pursuant to a state court decree). ERISA, on the other hand, permits voluntary, revocable assignments of up to 10% of an employee's retirement benefits and assignments of the full vested portion of the benefit to the employer as security for a loan. 29 U.S.C. § 1056(d)(2) (1976); see also I.R.C. § 401(a)(13). ERISA also contemplates collection of state and federal taxes directly from the plan. Treas. Reg. § 1.401(a)-13(c)(2)(ii) (1978). Third, the Railroad Retirement Act also specifically provides to a worker's spouse an individual benefit which terminates on divorce, indicating congressional intent not to permit divorced spouses to enjoy benefits. 42 U.S.C. § 231d(c)(3) (1976). ERISA has no comparable provision.

27. DAILY TAX REPORT (BNA) G-1 (Jan. 22, 1980).

28. 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978).

29. In *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978), the husband had retired and was receiving a pension when the couple was divorced. Mrs. Stone was awarded a share of her husband's pension in the dissolution proceeding. He apparently fled the jurisdiction. She then sued Mr. Stone and the plan in state court seeking to collect her share from Mr. Stone or, in the alternative, directly from the plan. Mr. Stone defaulted but the plan removed the case to federal court. The court held that ERISA § 514(a), 29 U.S.C. § 1144(a) (1976), does not preempt California community property laws, that the award of an interest in a pension plan to the nonemployee spouse is not a prohibited assignment under ERISA section 206(d)(1), 29 U.S.C. § 1056(d)(1) (1976), and that a nonemployee spouse may sue the plan directly to collect a share of the matured pension. 450 F. Supp. at 920, 923-33. *Stone* has been followed by California courts deciding the issue. *In re Marriage of Pilatti*, 96 Cal. App. 3d 63, 157 Cal. Rptr. 594 (1979); *In re Marriage of Campa*, 89 Cal. App. 3d 113, 152 Cal. Rptr. 362 (1979), *appeal dismissed for want of a substantial federal question*, 100 S. Ct. 696 (1980); *In re Marriage of Johnston*, 85 Cal. App. 3d 900, 149 Cal. Rptr. 798 (1978); *Johns v. Retirement Fund Trust*, 85 Cal. App. 3d 511, 149 Cal. Rptr. 551 (1978).

30. A motion for summary dismissal of the appeal because of *Campa* was filed in *Stone* by attorneys for appellants. Application for Order to Dispense with Oral Argument and Summarily Affirm the Judgment of the District Court, *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978) (on file with *The Hastings Law Journal*). The Ninth Circuit denied the motion on March 25, 1980.

reluctant to litigate the preemption issue in light of the Supreme Court's action and the government's administrative posture, because to do so may expose it to liability for wasted trust assets. As Justice Brennan aptly stated in his dissent to the denial of certiorari in *Colorado Springs Amusements, Ltd. v. Rizzo*:³¹

Resolution of important issues, in my view, ought not to be made solely on the basis of a single jurisdictional statement, without the benefit of other court decisions and the helpful commentary that follows significant developments in the law. . . . [N]o court will again consider the merits of the question presented to this Court. . . . [P]uzzled state and lower court judges are left to guess as to the meaning and scope of our unexplained dispositions.³²

Even if the *Campa* decision were satisfactory in a jurisprudential sense, a definitive resolution of the preemption issue alone would not resolve the problems of accommodation of the interest of the nonemployee spouse. That interest still must be accommodated under ERISA in a manner that comports with the goals of the statute. Satisfaction of the nonemployee spouse's interest accordingly should be at small additional cost to the retirement plan and its administrator, should preserve the financial integrity of the plan, and should protect the interests of all participants in the plan as well as those of the individual spouses. These goals can best be achieved if the trustee or plan administrator is given flexibility in making independent distributions to both the nonemployee spouse and the employee spouse, within the basic structure of ERISA-regulated plans. This Article describes the structure and operation of employee benefit plans under ERISA and sets out legislative proposals designed to accommodate the nonemployee spouse's marital property interest. Because most ERISA covered plans are also tax qualified under Internal Revenue Code sections 401 to 415,³³ the tax aspects of disposition of retirement benefits on divorce, together with proposed changes in the current law, are discussed.

Description of Employee Benefit Plans Covered by ERISA

ERISA was enacted to protect the interests of participants and beneficiaries in employee benefit plans.³⁴ It establishes dual jurisdic-

31. 428 U.S. 913 (1976).

32. *Id.* at 917-19 (Brennan, J., dissenting).

33. I.R.C. §§ 401-415. See note 51 & accompanying text *infra*.

34. 29 U.S.C. § 1001 (1976). Title II of ERISA is now incorporated into the Internal Revenue Code, primarily in I.R.C. §§ 401-415. In this Article, "Act" references are to sections of Titles I, III and IV of ERISA, 29 U.S.C. §§ 1001-1144, 1201-1242, 1301-1381 (1976); references to those provisions that are part of the Internal Revenue Code are so identified.

tion in the Departments of Labor and Treasury over all funded employee benefit and welfare plans,³⁵ except governmental and church plans,³⁶ established by any employer or employee organization engaged in commerce.³⁷

ERISA consists of four titles. Title I³⁸ is concerned primarily with plan administration. It defines who is a fiduciary,³⁹ imposes standards of fiduciary conduct,⁴⁰ requires reporting of the plan's financial status to the Labor Department,⁴¹ and requires disclosure to the participants

35. Title III of ERISA sets out the jurisdiction, administration, and enforcement responsibilities of the Secretary of the Treasury and the Secretary of Labor. 29 U.S.C. §§ 1201-1204 (1976). Dual jurisdiction over ERISA has presented serious administrative difficulties. The responsibilities of the Internal Revenue Service and the Department of Labor were realigned effective January 1, 1979, under Reorganization Plan No. 4. Announcement 79-6, 1979-4 I.R.B. at 43. Section 401 of Senate Bill 209 would establish a single agency, the Employee Benefits Commission, to administer ERISA. Senate Bill 209 is discussed briefly at note 25 *supra*.

36. 29 U.S.C. § 1003(b) (1976). A governmental plan is a plan established or maintained for its employees by the United States government, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. Governmental plans also include plans covered by the Railroad Retirement Act and plans of international organizations. 29 U.S.C. § 1002(32) (1976). For a description of the operation of the Railroad Retirement Act, see *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 573-77 (1979).

A church plan is one established and maintained for its employees by a church or convention of churches which is exempt from taxation under I.R.C. § 501, but not for employees of an unrelated business under I.R.C. § 513. 29 U.S.C. § 1002(33) (1976). A "church plan" may elect to be covered by some of the provisions of ERISA under I.R.C. § 410(d). 29 U.S.C. § 1003(b)(2).

37. 29 U.S.C. § 1003(a) (1976). The statute also includes employers or employee organizations in any industry affecting commerce. The determination of whether an employer is engaged in interstate commerce seems to be a factual one which has at times been interpreted expansively. *Gulf King Shrimp Co. v. Wirtz*, 407 F.2d 508 (5th Cir. 1969); *Clyde v. Broderick*, 144 F.2d 348 (10th Cir. 1944). However, there are some limits. Employees building a dam for water for an industrial city were held not to be engaged in activities directly and vitally related to the movement of goods or persons in interstate commerce. *Mitchell v. H.B. Zachry Co.*, 362 U.S. 310 (1960). See also *Mitchell v. Krout*, 150 F. Supp. 857 (N.D. Cal. 1957). In general, a doctor or lawyer engaged in a practice with local intrastate patients or clients probably is not engaged in interstate commerce. But see *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975).

38. 29 U.S.C. §§ 1001-1144 (1976).

39. The definition of a fiduciary is not a model of clarity. It is defined in the Act as one who exercises any authority or control respecting management or disposition of plan assets, renders investment advice for compensation, or has the authority or responsibility in the administration of a plan. 29 U.S.C. § 1102(21)(A) (1976). The "named fiduciary" may be named in the plan or selected according to a procedure set out in the plan. 29 U.S.C. § 1102(a)(2) (1976). However, fiduciaries need not be named fiduciaries and the term casts a broad net. See *Definitions and Coverage under the Employment Retirement Income Security Act of 1974, Definition of "Fiduciary,"* 29 C.F.R. § 2510.3-21 (1979).

40. 29 U.S.C. §§ 1101-1113 (1976).

41. *Id.* § 1023 (annual report of financial and actuarial soundness of the plan).

and beneficiaries of their rights and benefits under the plan.⁴² Title I also sets forth the right of a participant or beneficiary to bring suit in either federal or state court to clarify or enforce his or her rights to benefits under the plan.⁴³ Title II,⁴⁴ which together with Title I comprises the core of ERISA's regulatory scheme, governs taxation of the employer, the employee, and the trust or other funding medium of the plan. Title III⁴⁵ provides for administration and enforcement of ERISA and establishes a congressional joint task force to study ongoing problems of ERISA, including preemption.⁴⁶ Finally, Title IV⁴⁷ establishes the Pension Benefit Guaranty Corporation.

Although a detailed analysis of the requirements for establishing a plan under ERISA is beyond the scope of this Article, a description of the basic principles governing such plans is essential to understanding the problems arising from nonemployee spousal rights in such plans. All plans established and maintained by private employers⁴⁸ or employee organizations, and plans to which an employer is required to contribute under a collective bargaining agreement, are subject to Title I of ERISA. Included within this broad rubric are plans that provide current benefits such as medical, death, or disability benefits, vacation pay, and bonuses in the form of stock in the employer company.⁴⁹ These plans present little or no problem to a state court awarding mari-

42. Each participant must receive a summary plan description (SPD) within 90 days after becoming a participant, with 5 or 10 year updates. 29 U.S.C. § 1024(b)(1) (1976). The SPD describes the plan and identifies the administrators and trustees of the plan. *Id.* § 1022(b). One of the most challenging requirements of ERISA is that the SPD "be written in a manner calculated to be understood by the plan participant." *Id.* § 1022(a)(1). See Junewicz, *Portfolio Theory and Pension Plan Disclosure*, 53 N.Y.U.L. REV. 1153 (1978); Miller & Dorenfeld, *ERISA: Adequate Summary Plan Descriptions*, 14 Hous. L. REV. 835 (1977). Each participant also is entitled to request annually a statement of his or her benefits, including a statement of when benefits will be nonforfeitable. 29 U.S.C. § 1025(a) (1976).

43. 29 U.S.C. § 1132(a)(1)(b) (1976). The participant's rights to proceed against the plan are discussed in Phillips, *Civil Litigation Under the Employee Retirement Income Security Act of 1974*, 49 Miss. L.J. 241 (1978); Note, *Private Enforcement of Employees Retirement Income Security Act*, 47 U. CIN. L. REV. 272 (1978).

44. Codified primarily in I.R.C. §§ 401-415.

45. 29 U.S.C. §§ 1201-1242 (1976).

46. *Id.* § 1222(a)(4). The task force was to have made a full study by September 2, 1976, of, *inter alia*, the effects and desirability of federal preemption of state and local law with respect to matters relating to pension plans. *Id.* § 1222(a). It failed to complete its study by that date.

47. *Id.* §§ 1301-1381.

48. Public plans are expressly excluded from ERISA. See note 36 *supra*.

49. 29 U.S.C. § 1002(1)-(3) (1976). Stock options should be considered part of the marital property. See, e.g., McNamara, *California Community Property Aspects of Executive Compensation*, U.S. CAL. 1978 TAX. INST. 151, 152. This may produce the undesirable re-

tal property to the nonemployee spouse; the benefits from such plans either are currently enjoyable and distributable or do not represent a right of the marital community, but rather of the individual spouse who becomes entitled to them. For example, health insurance or annual vacation pay either benefits the community during the marriage or inures to the individual benefit of the employee upon separation or dissolution of the marriage.⁵⁰

The types of plans covered by Title I that are troublesome, and which are the focus of this Article, are those plans that provide *deferred* employee benefits, primarily in the form of post-retirement annuities or other payments. The vast number of these plans also will be covered by Title II, which covers tax "qualified" benefit plans within the intentment of Internal Revenue Code sections 401-415. The coverage of the two titles is not congruent, however; some plans will be covered solely by Title I⁵¹ and others will be covered only by Title II.⁵²

Defined Benefit Plans

Essentially, there are two types of tax qualified deferred employee benefit plans: defined benefit and defined contribution plans.⁵³ Defined benefit plans, commonly thought of as pension plans, specify the amount to be paid to an employee upon attainment of a stated age, usually sixty-five,⁵⁴ or some other event. The benefit in its simplest

sult, particularly in a closely held corporation, that nonemployee former spouses may own stock in the company.

50. For example, in California, disability benefits paid after separation are the separate property of the disabled employee spouse. CAL. CIV. CODE § 4800(c) (West Supp. 1980). However, if the employee spouse may elect between regular retirement benefits and disability benefits and he or she chooses the latter, an amount equivalent to the regular retirement benefits will, to the extent attributable to employment during marriage, be treated as a community asset subject to disposition between the parties. *In re Marriage of Stenquist*, 21 Cal. 3d 779, 582 P.2d 96, 148 Cal. Rptr. 9 (1978).

51. Title I covers all employee plans which provide funded deferred benefits, 29 U.S.C. § 1002(2) (1976), even if they discriminate in favor of officers, shareholders, and highly compensated employees. *Id.* § 1051. Title II prohibits such discrimination for qualified plans. I.R.C. § 401(a)(4). The advantage of having a plan "qualify" under Title II is that the employer may take an immediate deduction for contributions to the plan within the limits of I.R.C. § 404; the assets accumulate tax free in the fund, I.R.C. § 501; and the participants and beneficiaries are not taxed on benefits until actually distributed and then often at very favorable income tax rates, I.R.C. § 402.

52. See note 51 *supra*.

53. I.R.C. § 414(j)-(j).

54. The usual retirement provisions of pension plans also must meet the requirements of the Age Discrimination in Employment Act, 29 U.S.C. §§ 621-634 (1976), as amended by Age Discrimination in Employment Act Amendments of 1978, Pub. L. No. 95-256, § 1, 92 Stat. 189 (1978), which prevents mandatory retirement before age 70. See generally Note,

form may be expressed as a fixed dollar amount payable monthly for the life of the employee. More commonly, it is expressed as a percentage of the employee's compensation or as a percentage of compensation with a factor for years of service. There also may be a provision for cost of living adjustments as well as an offset or reduction for Social Security payments received by the participant.⁵⁵ Essentially, these plans provide an ascertainable income for the retirement years of the participant or of the participant and his or her spouse.

The employer's contributions to a defined benefit plan are based on actuarial calculations made after analyzing the employee population covered by the particular plan. The factors used in the analysis include age, sex,⁵⁶ rate of turnover, and assumed investment expectations, which depend on the nature of the investment medium and its expected return to the trust or custodial account. Employer contributions are made to the fund as a whole and are not allocated to the account of any specified participant prior to his or her termination of employment. A defined benefit plan also may permit or require contributions from employees who are participants, but these contributions may be held in individual accounts.⁵⁷ If participants terminate employment prior to acquiring a vested right to receive benefits upon retirement, the employer's future contributions are reduced by the amount forfeited by such participants.⁵⁸

Certain significant consequences flow from the payment of ascertainable retirement benefits under a defined benefit plan. First, the plan and the trust or annuity policies that serve as its funding medium cannot provide any other kind of benefits, including death benefits, un-

Mandatory Retirement and the Age Discrimination in Employment Act of 1976, 1977 U. ILL. L.F. 927, 929.

55. I.R.C. § 415(d)(1). Plans that correlate benefits with Social Security are said to be "integrated." Many defined benefit plans and defined contribution plans are "integrated." The rules for properly integrating a qualified plan are complex and beyond the scope of this Article. They are set out in Rev. Rul. 71-446, 1971-2 C.B. 187, *as updated by* Rev. Rul. 75-480, 1975-2 C.B. 131, *and* Rev. Rul. 76-76, 1976-1 C.B. 106. For a thorough discussion of the concept of integration, see D. MCGILL, *FUNDAMENTALS OF PRIVATE PENSIONS* 166-90 (3d ed. 1975).

56. *But see* City of Los Angeles, Dept. of Water & Power v. Manhart, 435 U.S. 702 (1978) (which held that a requirement that women contribute more than men to a defined benefit plan due to their greater longevity as a class violated Title VII of the Civil Rights Act of 1964). *See also* Bernstein & Williams, *Sex Discrimination in Pensions: Manhart's Holding v. Manhart's Dictum*, 78 COLUM. L. REV. 1241 (1978).

57. I.R.C. §§ 411(b)(2), (c).

58. Rev. Rul. 60-73, 1960-1 C.B. 155. *See* I.R.C. § 401(a)(8); Treas. Reg. § 1.401-7(a) (1963).

less they are "incidental" to the primary retirement benefit.⁵⁹ The extent to which such benefits may be considered incidental has been established by Internal Revenue Service regulations and rulings.⁶⁰ Moreover, a defined benefit plan generally cannot permit withdrawals from the plan by participants prior to the time stated for benefit payments to commence,⁶¹ although adequately secured loans may be made to participants prior to that time.⁶² Somewhat surprisingly, once the benefits become payable there is no comparable requirement that the benefits be paid out over the lifetime of the retired participant; they may be paid in a lump sum or over a period certain that may be less than the expected remaining life span of the participant.⁶³ They may not, however, be paid out in such a manner that their primary benefit is to someone other than the participant and his or her surviving spouse.⁶⁴

Defined Contribution Plans

The other major type of qualified deferred employee benefit plan is a defined contribution plan.⁶⁵ Under this type of plan the employer makes contributions of a definite amount each year. The amount is either fixed, determined in accordance with a specified formula, or determined by the employer annually.⁶⁶ Contributions also may be required of or permitted from participants.⁶⁷ In a defined contribution plan, one or more accounts are established for each participant in the plan. Employer contributions are allocated to the participants' accounts in accordance with a set formula, which usually relates only to compensation but may include a factor for years of service.⁶⁸ Amounts

59. Treas. Reg. § 1.401-1(b)(1)(i) (1976).

60. *Id.* See also Rev. Rul. 69-523, 1969-2 C.B. 90; Rev. Rul. 61-121, 1961-2 C.B. 65.

61. See Rev. Rul. 74-254, 1974-1 C.B. 91; Rev. Rul. 69-421, Part 2(o), 1969-2 C.B. 59. ERISA does not appear to have changed the law in this regard.

62. Treas. Reg. § 1.401(a)-13(d)(2) (1978).

63. See Rev. Rul. 71-296, 1971-2 C.B. 202. However, a pension plan cannot provide solely for distributions in a lump sum form. Rev. Rul. 62-195, 1962-2 C.B. 125.

64. Rev. Rul. 72-241, 1972-1 C.B. 108; Rev. Rul. 72-240, 1972-1 C.B. 108; Rev. Rul. 56-656, 1956-2 C.B. 280. See Rev. Rul. 74-359, 1974-2 C.B. 129; Rev. Rul. 74-325, 1974-2 C.B. 127; Rev. Rul. 74-360, 1974-2 C.B. 130.

65. A defined contribution plan provides an individual account for each participant and for benefits based solely on the participant's account balance. I.R.C. § 414(i).

66. See M. CANAN, QUALIFIED RETIREMENT PLANS § 3.12 (1977). Employer contributions to profit sharing or stock bonus plans can vary from year to year, but employer contributions to money purchase plans must be made in accordance with a fixed formula.

67. See I.R.C. § 401(a)(1); I.R.C. § 411(c)(2)(C); Rev. Rul. 70-658, 1970-2 C.B. 86; Rev. Rul. 69-421, 1969-2 C.B. 58.

68. See Rev. Rul. 68-653, 1968-2 C.B. 177; *but see* Rev. Rul. 68-654, 1968-2 C.B. 179 (factor for years of service not allowable if it results in discrimination in favor of highly compensated employees).

reflecting the participants' share in earnings of the fund and the expenses of administration also will be credited or debited to each account. Amounts forfeited by participants whose employment terminates prior to full vesting usually will be allocated to the accounts of the remaining participants.⁶⁹

The allocation of funds to a participant's account does not necessarily give the participant any rights to such amounts, but simply provides a means for determining that participant's present share of assets in the plan. The participant will become entitled to his or her entire account balance only when it has fully vested under the plan. In addition, the amount of benefits to which a particular participant ultimately is entitled in a defined contribution plan depends entirely upon the contributions credited to his or her account, the performance of the investment medium, and, in stock bonus or profit sharing plans, the turnover rate of other participants whose forfeited amounts may be allocated to the accounts of the remaining participants.⁷⁰ Thus, in a defined contribution plan the benefits ultimately payable to a participant will not be known with certainty until such benefits are to commence, although the value of the accrued benefits always can be ascertained.

Within the category of defined contribution plan, there are two subcategories. The first is the well-known "profit sharing" plan, whose name suggests its genre. Employer contributions to a profit sharing plan will be made if and only if the employer does in fact have "profits" as the terms may be defined in the plan.⁷¹ Thus, under a profit sharing plan, the level of benefits ultimately achieved is determined not only by the amount of contributions the employer intends to make and the return on such contributions, but also on the general prosperity of the employer's business. A profit sharing plan must provide for withdrawal of funds after a fixed number of years, the attainment of a

69. See I.R.C. § 414(i). Such allocations must not be made in a method which is discriminatory in favor of the prohibited group of employees. See *Ryan School Retirement Trust v. Commissioner*, 24 T.C. 127, 133-34 (1955); I.R.C. § 401(a)(4). Allocations of forfeitures made on the basis of account balances will not cause the plan to fail to qualify under I.R.C. § 401 unless they result in the discrimination prohibited by I.R.C. § 401(a)(4), Rev. Rul. 71-4, 1971-1 C.B. 120, but the Internal Revenue Service often may require that allocations be made in proportion to nondeferred compensation. The total "annual addition" (which is the sum of employer contributions, a portion of employee contributions, if any, and forfeitures to a participant's account) cannot exceed the lesser of \$36,875 or 25% of the participants' compensation. I.R.C. § 415(c)(1)-(2).

70. I.R.C. § 414(i).

71. See Treas. Reg. § 1.401-1(a)(2)(ii) (1976). "Profits" may be defined according to generally accepted accounting principles and are not limited to taxable profits or "earnings and profits." Rev. Rul. 66-174, 1966-1 C.B. 81, 82.

stated age, or upon the occurrence of some hardship.⁷² In addition, the plan may provide for incidental life insurance or accident or health insurance.⁷³

In contrast, the second type of defined contribution plan, a money purchase pension plan, is one in which the employer makes a commitment to contribute a fixed amount to the plan regardless of the company's success.⁷⁴ The amount may be a stated dollar amount or a stated percentage of the participant's compensation.⁷⁵ The contributions and earnings thereon are allocated to participants' accounts as in a profit sharing plan but are subject to some of the limitations of defined benefit pension plans, including a prohibition of early withdrawals⁷⁶ and restrictions against providing other types of benefits. Here, too, participant forfeitures may reduce employer contributions.⁷⁷

ERISA Regulation

Every deferred employee benefit plan involves two broad sets of rules. One set governs the employees and determines who shall be covered by the plan, how long they will have to remain in the plan to become entitled to benefits, and when, and in what form, the benefits will be paid out to the employee or to that employee's beneficiary. The other set of rules governs the fiduciary and establishes the standards of fiduciary responsibility for funding the plan and investing its assets. Prior to the enactment of ERISA, the rules governing coverage, vesting, and distribution of benefits were based primarily on standards of reasonableness and the exclusive benefit of the employees.⁷⁸ Such rules are now subject to more stringent minimum standards under ERISA.

72. Treas. Reg. § 1.401-1(b)(1)(ii) (1976). The term "fixed number of years" is considered to mean at least two years. Rev. Rul. 73-553, 1973-2 C.B. 130; Rev. Rul. 71-295, 1971-2 C.B. 184. The regulation lists events which may be grouped under the term "hardship." They are "layoff, illness, disability, retirement, death, or severance of employment." Treas. Reg. § 1.401(b)(1)(ii) (1976). If the participant has the right to withdraw employer contributions, certain penalty provisions usually are included to avoid the constructive receipt of income.

73. Treas. Reg. § 1.401-1(b)(1)(ii) (1976). See Rev. Rul. 76-353, 1976-2 C.B. 112; Rev. Rul. 69-421, 2(N), 1969-2 C.B. 59; Rev. Rul. 66-143, 1966-1 C.B. 79; Rev. Rul. 60-83, 1960-1 C.B. 157 (providing limits on amounts of life insurance which can be provided).

74. Rev. Rul. 73-379, 1973-2 C.B. 124.

75. M. CANAN, QUALIFIED RETIREMENT PLANS § 3.52 (1977).

76. Rev. Rul. 56-693, 1956-2 C.B. 282.

77. Rev. Rul. 60-73, 1960-1 C.B. 155.

78. For a discussion of these standards which highlighted their inadequacy and provided impetus for reform, see PRESIDENT'S COMMITTEE ON CORPORATE PENSION FUNDS AND OTHER PRIVATE RETIREMENT AND WELFARE PROGRAMS, PUBLIC POLICY AND PRIVATE PENSION PROGRAMS 70-79 (1965).

Deferred employee benefit plans must include all employees who have reached age twenty-five or who have completed one year of service with the employer.⁷⁹ Once such employees become participants in the plan, benefits begin to accrue on their behalf. Thus, most employees whose employers have established benefit plans will be included in a plan or plans, unless they are subject to a collective bargaining agreement that does not provide for coverage under such a plan.⁸⁰ An employee may not be entitled to all or any of the benefits, however, if his or her employment terminates prior to the time specified in the plan for vesting of the benefits. Under any of the new minimum vesting schedules mandated by ERISA, a participant must be fully vested in employer contributions after fifteen years of service with the employer and must be entitled to at least half of his or her benefit after ten years of service, although in many cases vesting may occur more rapidly.⁸¹ Thus, many participants in employee benefit plans are entitled to no benefits or to a very small percentage of their benefits in the early years of their employment with the employer but become irrevocably entitled to substantial benefits simply by continuing in their present employment.⁸²

Once an employee is included in the plan and has accumulated vested benefits, the question arises as to when and in what form such benefits will be paid.⁸³ The payment of benefits must commence when the participant has attained the retirement age specified in the plan, but not later than the sixtieth day after the participant reaches age sixty-

79. I.R.C. § 410.

80. The bargaining must have been in good faith. I.R.C. § 410(b)(2)(A). Nonresident aliens without United States source income also can be excluded. I.R.C. § 410(b)(2)(c).

81. I.R.C. § 411.

82. Even if participants were to terminate employment and be rehired within a specified period of time, in general their prior service must be counted, provided they have not withdrawn their vested benefits upon termination or, if they have done so, provided that they agree to pay them back. I.R.C. § 411(a)(7)(B) & (C). This section provides that an employee whose service is terminated may be paid the present value of his or her vested benefit. If later rehired, he or she must have the opportunity to repay the amount so distributed, in which case the years of service prior to termination of employment will be counted in determining his or her accrued benefit. A defined contribution plan may give the right to repay only to employees who have been rehired within one year of termination (technically, prior to a "one year break in service"). Terminated participants in defined benefit plans have the right to buy back in to the plan for two years, but may be required to pay interest. Treas. Reg. § 1.411(a)-7(d)(4)(iv)(B); Treas. Reg. § 1.411(a)-7(d)(2)(ii)(1). These provisions provide a real incentive to both employees and plan fiduciaries to defer payment of even fully vested benefits until retirement.

83. The plan also must provide that benefits may not be assigned or alienated. 29 U.S.C. § 1056 (1976); I.R.C. § 401(a)(13).

five,⁸⁴ has completed ten years of participation in the plan, or has terminated employment, whichever occurs later.⁸⁵ Because of adverse tax consequences, benefits under a profit sharing plan are not likely to be distributed to a participant who remains an active employee prior to reaching age fifty-nine and one half.⁸⁶

When benefits become distributable, they may be paid in a lump sum, in installments over a fixed period, or in the form of an annuity. If the latter form of payment is available under a plan, ERISA prescribes that it be in the form of a joint and survivor annuity for the lives of the participant and his or her spouse,⁸⁷ although a participant may be given the option to elect a straight life annuity. If the benefits are distributed in the form of a lump sum, then the employee may "roll" them over into an individual retirement account (IRA) within sixty days of receipt of the distribution.⁸⁸ If the distributee does choose to roll over all or a portion of the lump sum distribution, that portion rolled over will not be taxed to him or her.⁸⁹ That portion which has not been rolled over will be taxed at ordinary income rates.⁹⁰ Benefits also may be distributed directly from the trustee of one plan to the trustee of another plan in which the employee is a participant.⁹¹

Amounts held in an IRA, whether because of a rollover or because of contributions made by an eligible employee,⁹² may not be distributed to the employee before he or she reaches the age of fifty-nine and one-half. If amounts are distributed before that time they will be subject to an additional ten percent tax.⁹³ Distribution must be commenced from an IRA before the employee reaches the age of seventy and one-half.⁹⁴ An IRA may be divided between the spouses on di-

84. See note 54 *supra*.

85. I.R.C. § 401(a)(14).

86. See I.R.C. §§ 402(a); 402(e)(4)(A)(ii). Tax aspects of distributions from qualified plans are discussed at notes 206-62 & accompanying text *infra*.

87. 29 U.S.C. § 1055 (1976); I.R.C. § 401(a)(11).

88. I.R.C. §§ 402(a)(5)(C), 408(d)(3).

89. I.R.C. §§ 402(a)(5), 403(a)(4), (b)(8).

90. I.R.C. § 402(a)(6)(C).

91. I.R.C. § 402(a)(5). A self-employed person may roll over distributions from a Keogh plan only to an IRA. I.R.C. § 402(a)(5)(E)(ii).

92. Under I.R.C. § 219, an employee who is not an active participant in a qualified plan may contribute the lesser of \$1,500 or 15% of his or her earnings to an IRA and deduct that amount in the year of contribution. If the employee has an unemployed spouse, he or she may establish a "homemaker IRA" for that person and contribute equally to both IRAs in a total amount not exceeding \$1,750. I.R.C. § 220.

93. I.R.C. § 408(f).

94. I.R.C. § 408(a)(6).

voiced with no adverse tax consequences at that time.⁹⁵

As the foregoing descriptions suggest, the rules for establishing and administering deferred employee benefit plans are quite complex. ERISA does not mandate, however, either that plans be established by or on behalf of employees or that they be continued once they are established.⁹⁶ Employee benefit plans covered by ERISA are private, voluntary, consensual arrangements arising out of individual or collective bargaining agreements and are not created, funded, or administered by the federal government. Congress merely enacted a federal regulatory scheme to ensure that the stated goals of such plans are achieved, by providing incentives for compliance in the form of tax benefits⁹⁷ and sanctions for violations in the form of fines, penalties,⁹⁸ and excise taxes.⁹⁹

To further the goals of ERISA, protection of the nonemployee spouse's interest in retirement benefits earned by the employee spouse must not impair the financial integrity of the plan, must be simple and cheaply administered, and must respect the interest of other participants, as well as the interests of both spouses. This requires legislation that focuses on all of the issues arising out of recognition of the nonemployee spouse's interest. Current legislative proposals simply provide that the nonemployee spouse's interest may be paid at the same time and in the same manner as the employee's benefit is paid without running afoul of the anti-assignment provisions of ERISA.¹⁰⁰ Such legislation does not go far enough to insure low cost, equitable, and efficient administration of the nonemployee spouse's interest in employee benefit plans.

If a portion of the benefits are to be paid to the nonemployee spouse from the plan, the most important issue to be resolved is how and when those benefits should be distributed. Subsidiary issues involve rights of the nonemployee spouse to receive information regarding the plan, to exercise independent elections under the plan over his or her share of the benefits, and to sue the plan independently for breach of fiduciary duties.

95. I.R.C. § 408(d)(6).

96. A plan must provide that all benefits are fully vested on termination of the plan, however. I.R.C. § 411(d)(3).

97. I.R.C. §§ 402, 404.

98. 29 U.S.C. §§ 1131, 1132 (1976).

99. I.R.C. § 4975.

100. S. 209, 96th Cong., 1st Sess. § 128 (1979). The text of § 128 of this bill is set out in note 25 *supra*.

Distribution of the Nonemployee Spouse's Share of the Benefits

Matured Benefits

If the benefits in question are matured and currently payable, distribution should be simple. Once the benefits are matured, their value is determinable and the nonemployee spouse's share then can be calculated easily. In distributing the benefits, the plan fiduciary should be authorized, upon receipt of a certified court order,¹⁰¹ to make payments to the nonemployee spouse. These payments could be made concurrently each month with payments to the employee spouse.¹⁰² If this is too onerous, the plan fiduciary could arrange to issue one check to the superior court which had jurisdiction over the divorce¹⁰³ or to a designated nominee for the spouses. Another possibility would be for the fiduciary to calculate the present value of the stream of payments to which the nonemployee spouse is entitled and pay him or her in a lump sum. Alternatively, the plan could buy a single premium, nontransferable annuity in satisfaction of the nonemployee spouse's interest.¹⁰⁴ Whatever modes of payment are made available, the plan fiduciary should have full discretion to determine the form of payment of benefits¹⁰⁵ and should not be required to use the same form of payment for each spouse.¹⁰⁶

Most of the cases that have dealt with the marital property preemption issue have involved matured and payable benefits, *i.e.*, benefits in a pay status.¹⁰⁷ The courts have focused on whether the state laws establishing the marital property rights have been preempted by

101. Filing of a certified court order with the plan is required under S. 209, 96th Cong., 1st Sess. § 128, 125 Cong. Rec. 555 (1979). It would certainly be sufficient notice to justify payment to the former spouse.

102. This would be a "two check" situation. The Internal Revenue Service has ruled that payments to a non-employee spouse pursuant to court order will not disqualify the plan if the benefits are in pay status. Rev. Rul. 80-27, 1980-4 I.R.B. at 8 (alimony and child support); Private Letter Ruling 7952045 (Sept. 25, 1979) (community property); Private Letter Ruling 8010051 (Dec. 12, 1979) (alimony).

103. See *In re Marriage of Fithian*, 74 Cal. App. 3d 397, 141 Cal. Rptr. 506 (1977).

104. The factors necessary for such calculations are available to any actuary or to the public. See Treas. Reg. § 20.2031-10 (1970).

105. The plan fiduciary should be given this authority in the interest both of protecting the plan and of preventing the Internal Revenue Service from ruling that the participant or the nonemployee spouse constructively received income from the plan prior to actual distribution by the plan fiduciary. See Treas. Reg. § 1.451-2 (1971).

106. For example, the fiduciary may pay the employee spouse a joint and survivor annuity, presumably for the joint lives of the participant and the second spouse, and pay the non-employee spouse a lump sum.

107. See notes 14-32 & accompanying text *supra*.

ERISA and whether payment to the nonemployee spouse violates ERISA's anti-assignment provisions. An underlying issue, more relevant here, which has been discussed by the courts only rarely is whether the nonemployee spouse is a permissible distributee of benefits from the plan. If not, distribution would be a breach of the "exclusive benefit rule" which imposes general fiduciary duties on the trustee to hold and manage plan assets for the exclusive benefit of participants or their beneficiaries.¹⁰⁸

An employee is defined as any individual employed by an employer¹⁰⁹ or who is an owner-employee under Internal Revenue Code Section 401(c).¹¹⁰ A beneficiary is defined as a person designated by an employee participant or by the terms of the plan who is or who may become entitled to receive benefits under the plan.¹¹¹ Technically, an employee's former spouse, whose interest in the benefits arises by operation of community property law, is neither an employee nor a beneficiary. Distribution to such persons therefore may run afoul of the exclusive benefit rule.

A recent Texas case, *Kerbow v. Kerbow*,¹¹² involved payments to nonemployee spouses who sued to collect benefits directly from the plan based on their community property claims. The court denied recovery solely on the basis that the former spouses were not "participants" or "beneficiaries" under the plan and therefore could not sue under section 502 of ERISA.¹¹³ More recently, however, the Internal Revenue Service has adopted a contrary position, ruling that once the benefits are in pay status a distribution may be made directly from the plan to a nonemployee spouse in satisfaction of court-ordered alimony and child support without disqualifying the plan.¹¹⁴ In addition, it has

108. 29 U.S.C. § 1104(a)(1) (1976).

109. *Id.* § 1002(6).

110. I.R.C. § 401(c).

111. 29 U.S.C. § 1002(8) (1976).

112. 421 F. Supp. 1253 (N.D. Tex. 1976).

113. *Id.* at 1260.

114. See note 102 *supra*. If a plan is disqualified, the employer will not be entitled to the I.R.C. § 404 deduction for contributions to the trust unless they are fully vested in the participants and individual accounts are maintained. Under I.R.C. §§ 83, 402(b), 404(a)(5), the trust will lose its tax-exempt status under I.R.C. § 501(a) since it no longer will relate to a qualified plan under I.R.C. § 401(a), and the vested amounts with respect to amounts contributed while the plan is unqualified immediately will become taxable to the employees on whose behalf they are held even though such amounts may not be distributed currently under the plan and trust to the employees in question. I.R.C. § 402(b); Treas. Reg. § 1.402(b)-1(b).

An unauthorized distribution also may constitute a prohibited transaction, defined in I.R.C. § 4975(c), and cause the imposition of taxes under I.R.C. §§ 4975(a) & (b) on any

ruled that a community property interest may be distributed to the nonemployee spouse from a Keogh plan when the employee reaches age fifty-nine and one-half (which is the earliest time at which a distribution may be made without incurring a penalty).¹¹⁵ Thus, there is little doubt that a spouse is now a permissible distributee for purposes of plan qualification under Title II. That result also should obtain under the fiduciary rules of Title I.

Vested Unmatured Benefits

If benefits under the plan are not currently payable but are fully vested, the problem of accommodating the nonemployee spouse's interest in those benefits becomes more complex. Should the spouse be entitled to immediate distribution of the vested benefits or should he or she be required to wait for payment until benefits are paid to the employee?

At the present time, ERISA does not contemplate current distribution of vested but unmatured benefits, nor does Senate Bill 209.¹¹⁶ The plan fiduciary thus is faced with a dilemma when confronted with a state court decree calling for immediate payment of vested but unmatured benefits. A current distribution of the nonemployee spouse's interest may affect the qualified status of the plan itself, because ERISA or the plan may not permit distribution of benefits prior to such stated events as the termination of employment by the employee, retirement,

disqualified person, defined in I.R.C. § 4975(e)(2), who participates in the prohibited transaction (other than a fiduciary acting only as such).

Moreover, the plan fiduciary may be exposed to criminal or civil liability. ERISA § 404, 29 U.S.C. § 1104 (1976), defines fiduciary duties. Under ERISA § 409(a), 29 U.S.C. § 1109(a) (1976), any person who is a fiduciary shall, among other things, be personally liable to make good any losses to the plan resulting from breaches of a fiduciary's responsibility and may be subject to other equitable or remedial relief. ERISA § 501, 29 U.S.C. § 1131 (1976), imposes criminal penalties on any person convicted of willfully violating any provision of Subtitle B, Part 1 of ERISA, 29 U.S.C. §§ 1021-1031 (1976). ERISA § 502, 29 U.S.C. § 1132 (1976), deals with civil enforcement and the assessment and collection of civil penalties relating to ERISA violations. For further discussion of the tax consequences to the plan, the participants and the employer, see Stogel & Ervin, *Keeping the Qualified Pension Plan Qualified and Recognizing the Tax Effects of Disqualification*, 1977 WASH. U.L.Q. 565.

115. Private Letter Ruling 7952045 (Sept. 25, 1979).

116. Section 128 of Senate Bill 209, S. 209, 96th Cong., 1st Sess. § 128, 125 Cong. Rec. 555 (1979), set out at note 25 *supra*, would permit payment from the plan in satisfaction of marital property rights. Payment could be made, however, only in the "two check" situation because the timing and form of benefit payments could not be altered under § 128. Moreover, the bill would not permit the nonemployee spouse to exercise independent elections under the plan. The bill may permit a fiduciary to make a different form of payment to the nonemployee spouse than to the employee, but would not permit state court decrees to require it to do so. *See also* Private Letter Ruling 8010051 (Dec. 12, 1979) (payment of court ordered alimony will disqualify the plan when the benefits are not in pay status).

death, disability, or attainment of a minimum age. On the other hand, the plan fiduciary may risk contempt of court or at least expensive litigation if it disregards a state court decree ordering immediate distribution to the nonemployee spouse. Like Pavlov's dogs, when confronted with two opposing directives and no instructions on how to select which to obey, the system has been suffering a proverbial nervous breakdown.¹¹⁷

Consequences of Premature Distributions

As noted previously, employer contributions to a pension plan may not be withdrawn prior to termination of employment or attainment of normal retirement age.¹¹⁸ A contribution by the employer to a profit sharing plan may be withdrawn two years after it has been made, if the plan so provides.¹¹⁹ Plans usually impose penalties for such withdrawals to prevent constructive receipt by the employee of the entire amount contributed on his or her behalf. Employee contributions under a defined contribution plan may be withdrawn at any time, if so provided in the plan, without affecting the tax status of the plan and trust. Again, the plan itself may provide penalties for such withdrawals.¹²⁰

Owner-employees who withdraw contributions prior to attainment of age fifty-nine and one-half are subject to a ten percent penalty tax.¹²¹ This penalty tax also applies to early distribution from an IRA.¹²² Thus, a distribution of unmatured benefits from the trust at the time of dissolution may violate requirements of the Internal Revenue Service and thereby jeopardize the qualified status of the plan. It may violate the terms of the plan, subjecting the fiduciary to charges of breach of fiduciary duty, or it may result in penalty taxes assessed against the employee.

117. See Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 489 (1954).

118. See notes 61, 76 & accompanying text *supra*.

119. See note 72 & accompanying text *supra*.

120. The tax consequences to the employee of in-service withdrawals are discussed in Lamon & Lee, *Pre-Retirement Qualified Plan Pay-outs under ERISA*, 9 CUM. L. REV. 83, 121-27 (1978).

121. I.R.C. § 72(m)(5). Under a contract purchased by an exempt trust, an insurance company loan received by an owner-employee or the pledge of an owner-employee's interest in a trust also will be treated as a distribution to the owner-employee. I.R.C. § 72(m)(4)(B).

122. I.R.C. § 408(f)(1). However, certain transfers of IRAs between spouses in connection with marital dissolutions are permitted without adverse tax consequences to either spouse. See I.R.C. § 408(d)(6).

Loans as Current Cashout Devices

Qualified plans may provide for nondiscriminatory loans to participants, secured by their vested benefits under the plan, without endangering the qualified status of the plan.¹²³ At the present time an employee spouse may borrow the amount necessary to satisfy the non-employee spouse's interest in the plan at the time of dissolution, providing the loan is adequately secured, bears a reasonable rate of interest, and is repayable within a reasonable period of time.¹²⁴

The use of participant loans to satisfy the nonemployee spouse's interest is a standard technique. Its use is not without risk, however. First, an employee ordinarily would not be ordered to borrow against future retirement benefits.¹²⁵ Consequently, the nonemployee spouse cannot be assured of a current distribution through the loan device. Second, the Internal Revenue Service may contend that a loan for a protracted period actually is a premature distribution. Such a ruling may have adverse tax consequences for the employee and, if premature distributions are not authorized in a profit sharing plan or if they are made from a pension plan, may result in plan disqualification.¹²⁶ Third, if the loan is to an owner-employee or from an individual retirement account it would be treated as a distribution, thus subjecting the employee to a penalty tax.¹²⁷ Finally, if the loan is to a key employee whose interest represents a substantial portion of the assets in the trust, the Internal Revenue Service may assert that there has been a partial or complete termination of the plan.¹²⁸

Proposed Mandatory Rollover IRA

For the reasons outlined above, there is currently no totally satisfactory method of paying out the nonemployee spouse's interest while the employee is employed. Nevertheless, current distribution is highly desirable, particularly in a defined contribution plan.

In a defined contribution plan, when the benefits are fully vested current distribution of the nonemployee spouse's interest makes good sense. Because the accrued benefit is equal to the balance standing in

123. I.R.C. § 401(a)(13); Treas. Reg. 1.401(a)-13(d)(2) (1978).

124. See I.R.C. §§ 401(a)(13), 4975(d)(1); Rev. Rul. 71-437, 1971-2 C.B. 185. See also Roberts, *Participant Loans from Qualified Plans—A Look after ERISA*, 57 TAXES 238 (1979).

125. Thiede, *supra* note 4, at 649.

126. For a discussion of the consequences of disqualification of the plan, see note 114 *supra*.

127. I.R.C. § 4975(d).

128. See I.R.C. § 411(d)(3); 29 U.S.C. §§ 1341-1343 (1976).

the participant's account as of a particular date, the nonemployee spouse's share may be ascertained easily. Withdrawal of the funds does not threaten the financial integrity of the plan because each participant's interest depends on his or her own account and not on the overall size of the fund.

Current distribution may be less desirable if a defined benefit plan is involved. This is because the benefits are funded through actuarial calculations which consider employer contributions, plan earnings, and anticipated forfeitures to ensure payment of a fixed level of benefits.¹²⁹ The financial integrity of the plan may be jeopardized by the premature distribution of benefits to a nonemployee spouse because such distributions would affect the actuarial factors used to fund the plan.

In a defined contribution plan where benefits are vested, and often in a defined benefit plan similarly vested, segregation of the nonemployee spouse's interest and removal from the plan often will be desirable because of the attendant reduction in the administrative burdens of handling that interest.¹³⁰ ERISA should be amended to authorize distributions, in the sole discretion of the plan fiduciary, of the nonemployee spouse's interest in retirement benefits in either a defined contribution or defined benefit plan, even if benefits are not currently payable to the employee.¹³¹ The plan administrator could balance the competing concerns while keeping the overall interest of the plan foremost in mind. State court orders are unlikely to do this.

Several aspects of a current distribution of unmatured benefits to the nonemployee spouse nonetheless are troublesome. First, it does not seem desirable to pay one spouse currently while the other spouse must wait until some future time to receive payment. In the extreme case, the possibility of a current distribution might lead to a divorce for the sole purpose of securing current distribution of at least the nonem-

129. See I.R.C. § 412 (establishing minimum funding standards for qualified employee benefit plans).

130. The spectre of onerous administrative costs to the plan if the nonemployee spouse is given the right to collect benefits therefrom often is raised in support of preemption of such interests. See, e.g., Brief for Appellant, Seafarer's International Union at 13; Briefs *amicus curiae* filed in support of Appellant by Carpenter's Pension Trust of Southern California, at 22-27, and by the ERISA Industry Committee at 11-18, *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978).

131. The nonemployee spouse's interest should be determined by a final state court decree. This is the solution adopted by Senate Bill 209, S. 209, 96th Cong., 1st Sess. (1979), 5 U.S.C. § 8345(h) (Supp. II 1978). The decree should contain sufficient information to determine the benefits payable to the spouse. See *Hearings Before the Comm. on Labor and Human Resources, United States Senate, on S. 209*, 96th Cong., 2d Sess. 589-601 (1979).

ployee spouse's share of the benefits.¹³² At best, current distribution to the nonemployee spouse could have a psychologically damaging impact on employee morale and diminish the incentive for long term employment which is the hallmark of employee benefit plans providing deferred benefits.

Second, current distribution undermines one of the major goals of ERISA, which is to provide for financial security of employees and their spouses during retirement years.¹³³ While profit sharing plans partake less of this goal than pension plans,¹³⁴ both profit sharing and pension plans contemplate accumulation during earning years for distribution during retirement years. Current distributions do not comport with that goal.

ERISA already contains the machinery to handle this problem. Individual retirement accounts, which afford employees a modified form of retirement benefit portability,¹³⁵ can be adapted easily to accommodate the interest of the nonemployee spouse to the goals of ERISA. ERISA should be amended to provide that if distribution of unmatured benefits are made to a nonemployee spouse, such distributions must be made to an IRA on his or her behalf. The requirement should be mandatory, not elective, on the part of the spouse. The funds so distributed thus would be kept in a "retirement plan solution" until the nonemployee spouse reached age fifty-nine and one-half or older,¹³⁶ without involving the plan in continued administration of those funds. Distribution to a mandatory IRA from a qualified plan also would be consistent with the tax free IRA division between the spouses on divorce already authorized by Internal Revenue Code Section 408(d)(6).¹³⁷ Distributions to an existing IRA or to the nonemployee spouse's own qualified plan also should be permitted.

132. There is already substantial impetus to divorce under the tax laws. *Compare* I.R.C. § 1(a) (taxes imposed on married individuals) *with* I.R.C. § 1(c) (taxes imposed on unmarried individuals). *See* Rev. Rul. 76-255, 1976-2 C.B. 40; *Mapes v. United States*, 576 F.2d 896 (Ct. Cl. 1978); *Tax Law's So Funny It Breaks Couple Up; IRS Isn't Laughing*, Wall St. J., Dec. 16, 1976, at 1, col. 4.

133. 29 U.S.C. § 1001(b) (1976).

134. The regulations define a profit sharing plan as one established "to enable employees or their beneficiaries to participate in the profits of the employer's trade or business." Treas. Reg. § 1.401-1(a)(2)(ii) (1976). A pension plan is established "to provide for the livelihood of the employees or their beneficiaries after the retirement of such employees." Treas. Reg. § 1.401-1(a)(2)(i) (1976).

135. *See* I.R.C. § 408. *See also* IRS, PUBLICATION 590, TAX INFORMATION ON INDIVIDUAL RETIREMENT SAVINGS PROGRAMS (1979).

136. I.R.C. § 408(f)(1) imposes a 10% penalty on distributions prior to age 59½. The penalty is measured by the amount of the distribution.

137. I.R.C. § 408(d)(6) permits tax free division of individual retirement accounts inci-

Nonvested or Partially Vested Benefits

Benefits that are nonvested or partially vested present several problems. First, in many jurisdictions retirement benefits may not be considered marital property until they are fully vested.¹³⁸ Second, where nonvested benefits are included as marital property, valuation of the benefit is very difficult. If retirement benefits are not vested at the time of dissolution, valuation depends in part on the likelihood of the employee remaining on the job until full vesting occurs.¹³⁹ Consequently, state courts often reserve jurisdiction over retirement benefits that are nonvested and dispose of them only when payable.¹⁴⁰ Third, distribution of nonvested benefits is not permitted under ERISA and would be a breach of fiduciary duty because of the adverse impact it would have on funding of the benefits of other plan participants.¹⁴¹ Therefore, distribution of nonvested benefits should not be permitted upon divorce.

If benefits are nonvested, or, in the case of vested unmatured benefits, if the plan fiduciary decides not to distribute currently,¹⁴² then distribution may be postponed for years. In that event, some method must be devised for ensuring that benefits are paid to the nonemployee spouse at the future time. One suggestion would require a court order to be served on a plan within ninety days of the commencement of benefits for the distribution to be effective.¹⁴³ This would require the nonemployee spouse to keep track of the employment status of the employee spouse for years after their relationship had been severed by divorce.

In the alternative, as in other areas, the mechanism which exists in ERISA may be modified to solve the problem. The whereabouts of the nonemployee spouse could be monitored by treating such a spouse as a "separated participant" under the plan. Plan administrators currently

dent to divorce. See also I.R.C. § 220, which permits deductions to an IRA on behalf of a nonemployed spouse when the employee spouse also maintains an IRA.

138. See note 8 *supra*.

139. For one method of valuing nonvested benefits, see Projector, *Valuation of Retirement Benefits in Marital Dissolution*, 50 L.A.B. BULL. 229 (1975).

140. See note 11 & accompanying text *supra*.

141. In a defined contribution plan, benefits which are forfeited by participants who terminate before full vesting may be allocated to the account of remaining participants. I.R.C. § 414(i). In a defined benefit plan, forfeitures are anticipated in the actuarial projections for funding the plan and therefore reduce employer contributions. See text accompanying notes 58, 69, 75, 77 *supra*.

142. See text accompanying note 130 *supra*.

143. See *Hearings Before the Comm. on Labor and Human Resources, United States Senate, on S. 209, 96th Cong., 2d Sess.* 589-601 (1979).

are required to file a form with the Social Security Administration on behalf of separated employee participants identifying their interests in the plan,¹⁴⁴ with the expectation that a participant whose employment terminated prior to retirement will be notified of the existence of benefits when he or she becomes eligible for Social Security. Similarly, the nonemployee spouse who is not going to receive immediate distribution can be registered as a "separated participant" and notified of the existence of benefits when becoming eligible for Social Security. In this way, plan fiduciaries need neither continuously monitor the employment status of former spouses nor depend on employees to keep track of their former husbands and wives. Plan fiduciaries who treat former nonemployee spouses as separated participants should be protected to the same extent that they are protected for separated employee participants regarding payment of benefits.

The concept of a "separated participant" requires some modification when applied to a former spouse. If the nonemployee spouse's interest is undistributed because it is nonvested, then his or her benefit should continue to vest but should not continue to accrue if the employee spouse continues in the service of the employer. This means that benefits which have accrued at the valuation date (which in a defined contribution plan would be the account balance and in a defined benefit plan would be the benefit accrued under the plan's provisions) would become nonforfeitable to the same extent they would have if the spouses had remained married. The benefits would not increase, however, either through additions to the account or additional accruals of defined benefits.¹⁴⁵

A final issue concerns the disposition of the nonemployee spouse's

144. I.R.C. § 6057(a), Form 5500, also known as Schedule SSA.

145. In the remote event that a nonemployee spouse subsequently becomes an employee of his or her former spouse's employer, the years of indirect service accrued solely by virtue of marriage should not be included in determining the nonemployee's rights as a new participant. Years of service are defined in I.R.C. §§ 410 & 411. Regulations relating to the concepts of "year of service," "hour of service," and "break in service" have been promulgated by the Secretary of Labor. Rules and Regulations for Minimum Standards for Employee Pension Benefit Plans, 29 C.F.R. §§ 2530.200b-1 to -9 (1979). Generally speaking, a participant credited with 1000 hours of service during a 12 consecutive month period (the "computation period") must be credited with a year of service. I.R.C. § 411(a)(5)(A); 29 C.F.R. § 2530.200b-1(a) (1979). An hour of service is each hour for which an employee is paid or entitled to be paid during the applicable computation period for performance of duties, and for vacation, illness, jury duty, layoff, military duty, or leave of absence. 29 C.F.R. § 2530.200b-2(a)(1) & (2) (1979). A one year break in service is a plan year in which a participant has 500 hours of service or less. I.R.C. § 411(a)(6)(A); 29 C.F.R. § 2530.200b-4(a)(1). Service prior to a one year break in service must still be counted for vesting purposes if an employee has completed one year of service after the one year break in service.

benefits if his or her whereabouts are unknown at the time of distribution. The issue, which arises whenever there are separated participants whose interests become payable years after their employment has terminated, presently is unresolved.¹⁴⁶ The question uniquely confronting the plan fiduciary when the disappearing distributee is a former non-employee spouse is whether the full benefit should be paid to the employee or should revert to the participants as a whole.

Again, common sense should prevail. The employee spouse should be entitled to the full benefit if the nonemployee spouse does not come forth to claim his or her share. Arguably, once the nonemployee spouse's interest is severed, the employee spouse's claim to it is no greater than that of any other participant. However, that argument ignores the fact that the employee spouse did earn the benefit. The policy reasons that mandate sharing of the benefit with a spouse whose efforts indirectly contributed to earning the benefit do not necessarily extend to sharing it with coworkers when that spouse cannot be found to be paid his or her share.

Death Benefits

Retirement plans often provide benefits after the death of the employee. The nature of the death benefit depends on the type of plan and the form of benefit distribution selected.

Death Benefits Under a Defined Contribution Plan

In a defined contribution plan, the total benefit payable to the employee at any time is determined by the balance in his or her account as of the relevant valuation date.¹⁴⁷ The typical death benefit accruing prior to commencement of payment in a defined contribution plan is simply the balance in the account of the participant on the date of death.

The benefit payable on death after termination of employment de-

I.R.C. § 411(a)(6)(B); 29 C.F.R. § 2530.200b-4(b). This issue, although remote should be delineated in amended regulations under I.R.C. § 411.

146. Treas. Reg. § 1.411(a)-4(b)(6) (1977) provides that state escheat laws work a permissible forfeiture of benefits where participants cannot be found. See CAL. CIV. PROC. CODE § 1521 (West Supp. 1980). Of course, proponents of total preemption may argue that such state laws are themselves preempted. See, e.g., Hutchinson & Ifshin, *Federal Preemption of State Law Under the Employee Retirement Income Security Act of 1974*, 46 U. CHI. L. REV. 23 (1978). The Labor Department issued an advisory opinion stating that California escheat laws are preempted by ERISA. Advisory Opinion 79-31, 252 PENSION REPORTER (BNA) A-18 (May 14, 1979).

147. I.R.C. § 411(a)(7).

depends on the mode of distribution selected, but in any case is computed only with reference to the undistributed account balance of the employee. Typically, there are three optional modes of settlement: lump sum; payment for a period certain; or an annuity, either for the lifetime of the participant alone or for the joint lives of the participant and spouse.

A lump sum distribution of the entire balance in the account would terminate the employee's interest in the plan. In contrast, an installment or annuity payment may involve payments after the death of the employee. Because the total amount of benefits payable depends entirely on the amount in the employee's account at retirement, payments made during the lifetime of the employee would, however, be reduced in anticipation of the death benefit payments. The property interest of the nonemployee spouse in a defined contribution plan nonetheless should be no different if payments are spread out over a period of years or made in a lump sum. The measure of the benefit is the same—the employee's account balance—whether paid during life or after death.

Death Benefits Under a Defined Benefit Plan

A defined benefit plan may provide for no death benefit other than a refund of the employee contributions made prior to retirement.¹⁴⁸ Typically, however, a plan will provide for a benefit payable to the surviving spouse if death occurs prior to commencement of payment to the participant. The amount of benefits payable would be equal to the accrued benefits of that participant, whether or not vested.¹⁴⁹ The death benefit available after benefit payments have commenced depends on the mode of payment selected. If a joint and survivor annuity is selected, the death benefit payable to the surviving spouse must equal at least one half of the benefit payable during the joint lives of the participant and the surviving spouse, but cannot exceed such lifetime benefit. The total benefit paid over the joint lives must be the actuarial equivalent of a single life annuity for the life of the participant.¹⁵⁰ As in a defined contribution plan, the lifetime benefits of the participant will be reduced if death benefits are to be paid, unless the plan provides that they be funded separately.

148. See, e.g., I.R.C. § 6057(a), Form 5500 (Question 4).

149. See M. CANAN, QUALIFIED RETIREMENT PLANS at app. C, § 5.3, at 598 for an example of a provision relating to a preretirement death benefit in a defined benefit plan.

150. I.R.C. § 401(a)(11)(G)(iii).

Death Benefits and the Terminable Interest Rule

Postdeath payments from the plan involve three separate questions which usually are erroneously intermingled in discussions of the subject. The first question is whether the nonemployee spouse has an interest in such benefits which should be evaluated in determining the amount of his or her marital property interest in the retirement benefits. The second question is whether the nonemployee spouse may collect or continue to collect an interest from the plan after the death of the former spouse. The last issue is whether the plan should distribute any unpaid portion of the nonemployee spouse's interest to that spouse's estate or should terminate his or her interest if he or she predeceases the employee. These questions, while left unanswered under ERISA, have been the focus of much attention in California. California's solution to the problem, via development of the so-called "terminable interest rule," is instructive in devising a scheme which will work under ERISA.

The terminable interest rule in California, as interpreted by cases¹⁵¹ and commentators,¹⁵² stands for the proposition that the interest of the nonemployee spouse in retirement benefits earned during marriage is limited to an interest in the benefits paid during the joint lives of both spouses. As such, the rule is justly subject to criticism as unfairly depriving the nonemployee spouse of the full measure of the marital property which is part of "the joint effort that comprises the community."¹⁵³ Analysis of the terminable interest rule, however, has

151. *In re Marriage of Fithian*, 10 Cal. 3d 592, 577 P.2d 449, 111 Cal. Rptr. 369, cert. denied, 419 U.S. 825 (1974), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Waite v. Waite*, 6 Cal. 3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Benson v. City of Los Angeles*, 60 Cal. 2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963); *Patillo v. Norris*, 65 Cal. App. 3d 209, 135 Cal. Rptr. 210 (1976); *In re Marriage of Freiberg*, 57 Cal. App. 3d 304, 127 Cal. Rptr. 792 (1976); *In re Marriage of Breugl*, 47 Cal. App. 3d 201, 120 Cal. Rptr. 597 (1975), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Frazier v. Tulare County Bd. of Retirement*, 42 Cal. App. 3d 1046, 117 Cal. Rptr. 386 (1974); *In re Marriage of Peterson*, 41 Cal. App. 3d 642, 115 Cal. Rptr. 184 (1974), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Bensing v. Bensing*, 25 Cal. App. 3d 889, 102 Cal. Rptr. 255 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976); *Berry v. Board of Retirement*, 23 Cal. App. 3d 757, 100 Cal. Rptr. 549 (1972).

152. An exhaustive analysis of the rule is found in Reppy, *supra* note 4, at 443-82. See also Thiede, *supra* note 4, at 638.

153. Reppy, *supra* note 4, at 482.

failed to consider the type of plan involved, the type of death benefit involved, or the procedural manner in which the issue was raised. Consequently, the rule has been misconstrued and misapplied in later cases and has been overly simplified by its academic detractors.

The origin of the terminable interest rule lies in cases relating to the right to terminate or amend state and local public retirement programs in derogation of the nonemployee spouse's right to benefits.¹⁵⁴ In *Packer v. Board of Retirement*,¹⁵⁵ the California Supreme Court held that a policeman's widow was not entitled to a widow's pension when her husband failed to elect a survivor benefit pursuant to a change in the law made after his employment had commenced. The court recognized that a pension to an employee's widow "is one of the elements of compensation held out to her husband"¹⁵⁶ and even conceded "that the husband's pension rights derived from his employment during marriage are community property."¹⁵⁷ The court held, however, that those factors "[did] not furnish any basis for the claim that the widow has a separate, vested right to a pension that is different from her community interest in her husband's pension rights."¹⁵⁸ Consequently, because her husband's pension rights could be modified during his employment, the widow's rights therein could be similarly modified.

Given the principle established in *Packer* that a widow's entitlement to pension benefits is terminated when the employee dies, it should come as no surprise that the court in *Benson v. City of Los Angeles*¹⁵⁹ held that a former spouse is not entitled to claim the death benefit as a "widow" but only as a holder of a community property interest therein, the value of which must be determined prior to the death of the employee.¹⁶⁰ The California Supreme Court in *Benson* was faced with the narrow question of whether a former spouse was entitled to collect a widow's benefit from the plan after the death of the employee when no disposition of the pension had been made in the prior divorce and the employee had remarried. The court held that the City need only comply with the terms of the employee's employment contract and make payments to the employee during his lifetime and on his death to his widow.¹⁶¹ When the employee died, the first wife's status with re-

154. *Id.* at 446.

155. 35 Cal. 2d 212, 217 P.2d 660 (1950).

156. *Id.* at 215, 217 P.2d at 662.

157. *Id.* at 216, 217 P.2d at 663.

158. *Id.*

159. 60 Cal. 2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963).

160. *Id.* at 358, 384 P.2d at 650, 33 Cal. Rptr. at 258.

161. *Id.* at 360, 384 P.2d at 651-52, 33 Cal. Rptr. at 259-60.

spect to the plan remained as co-owner of the employee's interest in the plan. That status limited her rights against the plan; a nonemployee spouse's rights are derived from the rights accorded an employee under the plan and are defined by the terms of the plan and by elections made by the employee under the plan. Accordingly, the only right which could be asserted against the plan was to enforce payments to his widow, *i.e.*, his *second* wife.¹⁶²

The court did not deny the former spouse the right to have the total benefits considered part of the community on divorce. Justice Peek stated:

This is not to say that upon a division of the community estate she could not have participated therein. Undoubtedly she had an interest which she could have asserted in the payments to [the employee] during his lifetime, had she sought to do so. But after [the employee's] death the only right remaining was to enforce the city's covenant to make payments to the "widow."¹⁶³

As this passage indicates, there is nothing in *Benson* to preclude a court from considering the survivor's benefit as part of the pension package earned during marriage and thus divisible on dissolution. *Benson*, however, has been interpreted by lawyers and courts in later cases as denying the nonemployee spouse *any* right to survivor benefits.¹⁶⁴ This view of *Benson* is incorrect for two reasons. First, it overlooks the distinction preserved in *Benson* between the right of the nonemployee spouse to a portion of the total pension package because of her community property interest therein and her right to the benefit as a widow, a status which she, as the former spouse, did not possess on the employee's death. Second, later cases have failed to analyze the death benefit at issue in *Benson* and thus have extended the rule of that case to fact situations in which it is clearly inapplicable.¹⁶⁵

162. *Id.* at 360, 384 P.2d at 652, 33 Cal. Rptr. at 260. The only right a surviving nonemployee spouse may have to postdeath benefits in a public retirement plan is to enforce the contract between the employee and the retirement system, even if that means he or she will receive no benefit. See *Frazier v. Tulare County Bd. of Retirement*, 42 Cal. App. 3d 1046, 117 Cal. Rptr. 386 (1974) (holding that an amendment to the plan permitting a surviving spouse to elect a death benefit was void as against a member of the plan who had previously designated a woman other than his wife as his beneficiary; since the amendment was void as to him, the surviving spouse could not claim the widow's benefit for which the statutes expressly provided).

163. 60 Cal. 2d at 360, 384 P.2d at 652, 33 Cal. Rptr. at 260.

164. See cases cited at note 151 *supra*, with the exception of *Patillo v. Norris*, 65 Cal. App. 3d 209, 135 Cal. Rptr. 210 (1976). In the later cases, all of the lawyers representing the nonemployee spouse conceded, either explicitly, or implicitly by failing to argue, that the spouse had no interest in death benefits.

165. See cases cited note 151 *supra*.

The death benefit in *Benson* was unrelated to years of service.¹⁶⁶ It was payable only to the dependents of any members of the Fire or Police Department who die as a result of injury or sickness suffered during performance of their duties or after retirement and was payable only during the period of their dependency. Furthermore, the death benefit was not optional, was not payable if there were no dependents, and involved no reduction of the lifetime pension payable to the employee.¹⁶⁷ A court faced with the type of death benefit in *Benson* at the time of divorce arguably could find that the employee had no property interest in the benefit¹⁶⁸ and correspondingly no marital property interest therein.

By contrast, the death benefit at issue in *Packer*, which allowed the employee to choose to have a lifetime benefit reduced in return for a death benefit payable to the surviving spouse, is the more usual type of death benefit. This type of benefit undoubtedly is a part of the pension *earned* during marriage. Extension of the terminable interest rule to such elective death benefits deprives the nonemployee spouse of his or her full marital property.¹⁶⁹

At least one case in California has recognized that the nonemployee spouse has a community property interest in death benefits payable under a private retirement plan. In *Patillo v. Norris*,¹⁷⁰ two ex-wives claimed a union pension fund death benefit against the designated beneficiary. The Court of Appeal relied on the:

[b]asic principle involved in the case of a married man who

166. See CHARTER OF CITY OF LOS ANGELES art. XVII, § 183 (1937, amended 1947).

167. See *id.* § 181.

168. For federal estate tax purposes decedents are considered to have no interest in death benefits with respect to which there is no contract or agreement and to which the decedent has no voice in designation of beneficiaries. See *All v. McCobb*, 321 F.2d 633 (2d Cir. 1963); *Estate of Barr v. Commissioner*, 40 T.C. 227 (1963), *acq.*, 1964-1 (Part 1) C.B. 4; Rev. Rul. 76-501, 1976-2 C.B. 267 and rulings cited therein.

169. Death benefits under ERISA necessarily will reduce lifetime payments. See notes 147-49 & accompanying text *supra*.

170. 65 Cal. App. 3d 209, 135 Cal. Rptr. 210 (1976). Professor Reppy apparently overlooked this case in his compendium on the terminable interest rule. Reppy, *supra* note 3. He also failed to note that the version of California Civil Code § 4363.2 in existence at the time of his Article permitted a plan to have a joinder order set aside on the ground that it had been ordered to make payments of benefits to the nonemployee spouse after the death of either spouse. CAL. CIV. CODE § 4363.2(c)(3)-(4) (1977) (amended 1978). This provision apparently would negate Professor Reppy's argument in chief that the principal fallacy in the terminable interest rule was that it was not explicitly based on legislation but operated in derogation of statutorily created rights. Reppy, *supra* note 3, at 481. Section 4363.2(c), which has since been amended to delete any reference to death benefit limitations, briefly imbedded the terminable interest rule firmly in the legislative foundation Professor Reppy found lacking.

designates someone other than his wife as the named beneficiary. To the extent . . . the benefits were earned by the husband from his employer during the marriage, on his death the wife is entitled to set aside the gift made to the named beneficiary without consideration and without her consent to the extent of one half of the community property interest.¹⁷¹

Although the marital relationships of the employee decedent were quite entangled and the record "sketchy and in some respects inadequate,"¹⁷² the court held that the benefit should be allocated in accordance with the funds attributable to the husband's employment for the duration of each relationship.¹⁷³ The court remanded for further determination of the actual length of each relationship.¹⁷⁴

With respect to ERISA-regulated private plans, there is no reason to exclude death benefits from the marital property rights in retirement benefits. If division of the retirement benefit is made at the time of divorce, the value of the death benefit can be determined actuarially in the case of defined benefit plans. The value of the benefit will be included automatically in the value of the participant's account in a defined contribution plan.¹⁷⁵ If a court retains jurisdiction, an allocation between the current and the former spouse can be made in the same manner as in *Patillo*, using the same time rule method which applies to lifetime benefits.¹⁷⁶

Nothing in ERISA prevents this result. ERISA does require that plans which provide for payment of benefits in the form of an annuity must provide for benefits "in a form having the effect of a qualified joint and survivor annuity."¹⁷⁷ That provision, however, shows no preference for the surviving spouse over the former spouse. For example, the requirement would not apply to plans which only provide for benefits in the form of lump sum payments or payments for a period

171. 65 Cal. App. 2d at 217, 135 Cal. Rptr. at 215 (citing, *inter alia*, *Benson v. City of Los Angeles*, 60 Cal. 2d 355, 384 P.2d 649, 33 Cal. Rptr. 257 (1963)).

172. 65 Cal. App. 3d at 212, 135 Cal. Rptr. at 212.

173. *Id.* at 218-19, 135 Cal. Rptr. at 216.

174. *Id.* at 217, 135 Cal. Rptr. at 215.

175. See notes 147-50 & accompanying text *supra*. Notably, this mode of division can only be provided for on divorce if the aggregate theory of community assets is used. On death, the surviving spouse's interest in each particular asset must be awarded under an item theory. See W. REPPY & W. DE FUNIAK, COMMUNITY PROPERTY IN THE UNITED STATES 444-45, 464-65 (1975). Thus the line of cases cited by Reppy as "anti-Benson" are inapposite because they involve the surviving spouse's community property interest in the benefit itself, rather than an interest at divorce where equivalent other property may be awarded. *Id.* at 458-62.

176. See note 11 *supra*.

177. 29 U.S.C. § 1055(a) (1976); I.R.C. § 401(a)(11)(A).

certain.¹⁷⁸ Moreover, plans may permit participants to elect out of the joint and survivor form of annuity by choosing some other form of payout, including a payment for the life of the participant alone¹⁷⁹ or to a beneficiary other than the surviving spouse.¹⁸⁰ Finally, the plan is not required to subsidize a benefit for the survivor, but may reduce lifetime benefits instead.¹⁸¹ In short, the death benefit payable to surviving spouses under ERISA differs significantly from that offered under federally funded retirement systems, including the Social Security Act and the Railroad Retirement Act,¹⁸² in that it is optional with the plan and elective by the participant. Accordingly, the joint and survivor annuity provision under ERISA cannot be construed to indicate a particular intent by Congress to provide for surviving spouses to the exclusion of former spouses.

In *Waite v. Waite*,¹⁸³ the California Supreme Court extended the rule in *Benson* to cover the issue of whether the nonemployee spouse's interest in the plan ceases on his or her death as well as on the death of the employee. Judge Waite and his wife divided all their community property except their respective pension rights upon separation in 1967. Thereafter, the Judge became a permanent resident of Nevada and was awarded his pension rights in an *ex parte* divorce proceeding in that state. His wife then filed for divorce in California, naming the State Comptroller, as administrator of the Judge's Retirement Fund, as an additional party. In disposing of the community property interest in the Judge's retirement fund, the trial court ordered the Comptroller to pay to the wife or her devisees or heirs one half of all the benefits payable under the Judges' Retirement Act.¹⁸⁴

On appeal, the California Supreme Court addressed itself solely to the question of the mode of division of the benefits. Justice Tobriner

178. See, e.g., PENSION AND PROFIT-SHARING FORMS (P-H), ¶¶ 30,605-30,606 (1977), for the Internal Revenue Service Model Profit Sharing Plan and Internal Revenue Service Model Money Purchase Plan. Neither provides for payment in the form of an annuity.

179. 29 U.S.C. § 1055(e)-(f) (1976); I.R.C. § 401(a)(11)(E)-(F).

180. 29 U.S.C. § 1055(e)-(f) (1976); I.R.C. § 401(a)(11)(E)-(F). If an employee does designate a beneficiary other than his or her spouse, the consent of the spouse should be secured. See J. ROBINSON & D. SOLOMON, ATTORNEY'S GUIDE TO PENSION AND PROFIT SHARING PLANS §§ 4.44, 5.38, 6.45 (1973).

181. H.R. REP. NO. 807, 93d Cong., 2d Sess. 67-68, reprinted in [1974] U.S. CODE CONG. & AD. NEWS 4670, 4732-33.

182. 42 U.S.C. §§ 301-1397 (1976); 45 U.S.C. §§ 201-231 (1976).

183. 6 Cal. 3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976).

184. 6 Cal. 3d at 466, 492 P.2d at 16, 99 Cal. Rptr. at 328.

found that lifetime pensions under the Judges' Retirement Act attributable to earnings during marriage were community property and, relying improperly on *Benson*, excluded any right to a widow's benefit.¹⁸⁵ The appellate court decision, which had precluded any payments to the wife's devisees or heirs, was upheld. As a result, the wife's community interest in pension benefits would yield payments to her during her lifetime only:

The state's concern . . . lies in provision for the subsistence of the employee and his spouse, not in the extension of benefits to such persons or organizations the spouse may select as the objects of her bounty. Once the spouse dies, of course, her need for subsistence ends, and the state's interest in her sustenance reaches a coincident completion. When this termination occurs, the state's concern narrows to the sustenance of the retired employee; its pension payments must necessarily be directed to that sole objective.¹⁸⁶

Consistent with that concern, the *employee's* estate would be entitled to nothing more than a refund of the employee's unrecovered contributions.¹⁸⁷ The only benefit payable after the death of the employee out of state funds would be to the employee's surviving spouse.¹⁸⁸ Thus, the court concluded that because the Judges' Retirement Act restricted payments of state funded benefits to the employee or the surviving spouse, the state administrator could not be required to make postdeath payments out of state funds to the nonemployee spouse's estate.¹⁸⁹

Justice Tobriner's opinion was in response to the Comptroller's assertion that he could not be obligated to make *any* payments to the former spouse but could only be required to make payments to the persons enumerated in the statute—retired judges and their spouses, designated beneficiaries, and children—none of which included a former spouse.¹⁹⁰ Thus, Justice Tobriner's concern in limiting the wife to payments for her lifetime was for the protection of the integrity of the fund itself. He went on to say that as between the spouses themselves, the former spouse could be compensated by receiving an award of more than half of some other community asset.¹⁹¹

Footnote nine in the *Waite* opinion enlarges on this distinction by explaining how the trial court may, in its discretion, compute the actua-

185. *Id.* at 472-73, 492 P.2d at 20-21, 99 Cal. Rptr. at 332-33.

186. *Id.* at 473, 492 P.2d at 21, 99 Cal. Rptr. at 333.

187. *Id.* at 473 n.7, 492 P.2d at 21, 99 Cal. Rptr. at 333.

188. *Id.* at 473, 492 P.2d at 21, 99 Cal. Rptr. at 333.

189. *Id.* at 474, 492 P.2d at 22, 99 Cal. Rptr. at 334.

190. Brief for Appellant Flournoy, *Waite v. Waite*, 6 Cal. 3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972).

191. *Waite v. Waite*, 6 Cal. 3d at 474, 492 P.2d at 22, 99 Cal. Rptr. at 334.

rial value of the benefit which cannot be paid directly from the plan.¹⁹² Although it has been described as an "oversight by the court,"¹⁹³ footnote nine is, on the contrary, entirely consistent with the court's holding that the wife had no interest enforceable against the plan after her death but nonetheless had an interest which could be included as part of the community property divisible between the spouses themselves.¹⁹⁴ In other words, the California Supreme Court has not permitted divisions of property on divorce to be made in a manner that would frustrate the provisions of the retirement plan itself. Subsequent cases have recognized this principle explicitly where direct division of the asset cannot be ordered.¹⁹⁵

192. *Id.* at 474 n.9, 492 P.2d at 22, 99 Cal. Rptr. at 334.

193. Reppy, *supra* note 3, at 456. Subsequent cases have not ignored footnote 9 in *Waite*, *see id.*, but have misapplied it. *See, e.g.*, *Berry v. Board of Retirement of the County of Los Angeles*, 23 Cal. App. 3d 757, 100 Cal. Rptr. 549 (1972), where the parties stipulated that if the husband retired and withdrew his contribution to the county retirement program, the wife would be entitled to half of the value of his contributions at the time of divorce. If he did not retire and withdraw his contribution, the court was to retain jurisdiction to make a fair and equitable division of the benefit between the parties. On the death of the husband prior to retirement, the ex-wife claimed a portion of the widow's benefit as her community property. The court denied her claim, in effect holding she waived it when she did not take the guaranteed sum but took her chances that the husband would live until retirement. *Id.* at 754, 100 Cal. Rptr. at 551. In other words, since no actuarial equivalent was determined at the time of divorce, any interest in the total benefit, including the employee spouse's contribution, was lost. This puts the wife between Scylla and Charybdis. She either must take a guaranteed amount based solely on employee contributions at the time of divorce, which is much less than the expected retirement benefit that would become payable if the employee lived to retirement, or risk losing all right to the benefits. *Berry* is a misapplication of both *Benson* and *Waite*.

194. The Internal Revenue Service has always recognized that the nonemployee spouse in a community property jurisdiction has an interest in post death benefits, even after ERISA. *See* Rev. Rul. 67-278, 1967-2 C.B. 323, which required that the interest of a nonemployee spouse in the employee's retirement plan be included in his or her gross estate if he or she predeceased the spouse. That ruling was overridden by the enactment of I.R.C. § 2039(d), which excludes the nonemployee spouse's interest from his or her gross estate in the same manner and to the same extent that I.R.C. § 2039(c) does for the employee spouse. I.R.C. § 2039(c), *as amended by* Tax Reform Act of 1976, Pub. L. No. 94-455, § 2009(c)(5), 90 Stat. 1896 (1976).

I.R.C. § 2517(c) extends a similar exclusion for gift tax purposes to nonemployee spouses who designate beneficiaries under plans. When the spouses are still married at the time of the nonemployee spouse's death, the presumption is that the deceased spouse would want the benefit to be payable in full to the employee spouse or to their jointly designated beneficiary and so the question of to whom the interest should be paid has not arisen. When the spouses are divorced, however, that question must be faced. *Waite* would simply permit the plan administrator to refuse to make payments to persons other than to the nonemployee spouse. *Waite v. Waite*, 6 Cal. 3d 461, 473, 492 P.2d 13, 21, 99 Cal. Rptr. 325, 333 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641 (1976).

195. *See, e.g., In re Marriage of Hisquierdo*, 19 Cal. 3d 613, 566 P.2d 224, 139 Cal. Rptr.

Thus, the terminable interest rule encompasses two distinct rights. One is the right to have postdeath payments included as part of the marital property which is subject to division on divorce and the other is the right to collect the marital property interest from the plan after the death of either spouse. If the terminable interest rule is read as a limitation on the latter right, it may make some sense. In this context, the rule would mean that the bifurcated payment of benefits will have to be made only to the principal parties: the employee and his or her former spouse. Questions of privity, as well as administrative costs of keeping track of multiple postdeath beneficiaries, would be avoided. Moreover, the congressional intention to provide for the surviving spouse, unless the plan or the participant specifies otherwise, would not be violated.

Application of the terminable interest rule to preclude recovery from the plan after the death of either spouse should not apply to valuation of the marital property interest in the retirement benefits itself. Valuation of that interest should turn on the account balance or the actuarial value of the accrued benefit and not on the form in which the benefit is to be paid out. Extension of the terminable interest rule to deny a marital property interest in death benefits is irrational and unfair. The proper approach would require valuation of the total benefit payable and selection of a mode of division of the marital property that does not require collection of death benefits from the plan by either the former spouse or his or her heirs. This could be accomplished by making a lump sum distribution to the nonemployee spouse¹⁹⁶ or by paying the nonemployee spouse an equivalent annuity computed with reference to the nonemployee spouse's life expectancy. Although the latter method might result in the nonemployee spouse receiving a larger portion of each payment than the employee does during their joint lives, an equivalent portion of the employee spouse's benefit would be payable to his or her surviving spouse or other beneficiary.

Incidental Rights of the Nonemployee Spouse

Participants and beneficiaries have many rights under ERISA be-

590 (1977), *rev'd*, 439 U.S. 572 (1979); *In re Marriage of Milhan*, 13 Cal. 3d 129, 528 P.2d 1145, 117 Cal. Rptr. 809 (1974). In *Hisquierdo*, the California Supreme Court awarded equivalent assets to a spouse who could not be awarded a share in the benefit itself. The availability of this technique in federally funded benefits has been precluded by the Supreme Court's reversal in *Hisquierdo*, but it still may be used to apportion postdeath benefits in private plans.

196. If the benefits were currently payable the lump sum could be paid to an individual retirement account. For a discussion of mandatory rollover IRAs, see notes 135-37 & accompanying text *supra*.

yond the right to receive benefits. They have the right to receive information about the plan and their benefits under it,¹⁹⁷ to sue for breach of fiduciary duty,¹⁹⁸ to make elections about the form of benefit payments, and to designate beneficiaries.¹⁹⁹ Amendments to ERISA should spell out which, if any, of these rights should be enjoyed by a nonemployee spouse.

A primary concern in evaluating these rights is the administrative burden that falls on the plan when asked to provide information or otherwise respond to requests from nonemployee spouses. Employee benefit plans often must deal with divorce lawyers seeking to subpoena records under the plan or asking for computations which the plans are not equipped to make.²⁰⁰ Lawyers naturally turn to the plan for information when the employee spouse is uncooperative and lawyers for both spouses may be unfamiliar with how the plans operate. A proper balancing of the administrative burden on the plan and the interest of the nonemployee spouse should be struck.

At the time of dissolution, a nonemployee spouse should be entitled to a copy of a current summary plan description and a statement of the employee's benefit entitlement as of the date closest to separation. Both documents currently are required to be prepared by the plan administrator²⁰¹ and need only be duplicated for the nonemployee. From these documents, the nonemployee spouse would have the data necessary to compute his or her claimed interest under the plan and to substantiate that claim in court. Because the information would be sought to determine the spouse's own benefit, which was jointly earned, disclosure should not violate the employee's right to privacy or subject the plan administrator to liability for providing the data.

There is no need for the plan to be further embroiled in the divorce proceedings until payment from the trust is required. The method adopted originally in California and recently by the federal government is a good one:²⁰² the plan should not be required to make

197. See note 42 & accompanying text *supra*.

198. See note 43 & accompanying text *supra*.

199. See notes 177-82 & accompanying text *supra*.

200. See, e.g., Brief for Appellant Seafarer's International Union, filed by Carpenter's Pension Trust of Southern California, *Stone v. Stone*, 450 F. Supp. 919 (N.D. Cal. 1978), *appeal docketed*, No. 78-2313 (9th Cir. June 21, 1978).

201. See note 42 & accompanying text *supra*.

202. See CAL. CIV. CODE § 5106 (West Supp. 1980). It is not clear whether this section has been repealed or superseded by CAL. CIV. CODE §§ 4363-4363.3 (West Supp. 1980). CAL. CIV. CODE § 4363 permits joinder of the plan in the divorce, which had previously been permitted judicially. CAL. CIV. CODE § 4363 (West Supp. 1980). See *In re Marriage of Pardee*, 408 F. Supp. 666 (C.D. Cal. 1976); *In re Marriage of Sommers*, 53 Cal. App. 3d 509,

payment over to the nonemployee spouse unless and until it has received notice of his or her claim via a state court decree or a marital property settlement. At that time, if the plan fiduciary believes that an interest of the plan would be impaired by complying with the order, or if it questions the validity of the order, the plan fiduciary could refuse to comply with the order, stating its reason therefor.

The nonemployee spouse should then have the right to sue the plan in either state or federal court²⁰³ to recover benefits so withheld. Without that right, an interest in the benefits would be virtually meaningless. Beyond that, the nonemployee spouse should have no rights to enforce ERISA. The provisions for public and private enforcement of ERISA²⁰⁴ adequately ensure that his or her interest in overall plan administration will be protected without the necessity of granting an independent cause of action. Satisfaction of a nonemployee spouse's interest from the plan itself does not require that he or she be given all the rights of a full participant; accordingly those rights should be circumscribed under the statute.

Finally, the nonemployee spouse should have a limited right of election over the form of payment of matured benefits. If the plan provides for both a lump sum payment and an annuity for life based on the present value of the benefit, the nonemployee spouse should be able to choose either. In neither case would the fiduciary be required to make payments after death. The valid concerns over administration which prompted the California Supreme Court's decision in *Waite v. Waite*²⁰⁵ would be respected by this limited form of election.

Tax Consequences of Disposition of Retirement Benefits

There are tax consequences attendant upon allocation of retirement benefits in a divorce and upon distribution of benefits to either or both spouses. Those consequences should be clear, simple, and easily administered. At the present time, however, none of these criteria are

126 Cal. Rptr. 220 (1975). Since § 4363 directly relates to an employee benefit and also deals with a subject covered by ERISA § 502(b), 29 U.S.C. § 1132(b) (1976), it probably is preempted under ERISA § 51, 29 U.S.C. § 1144 (1976). *But see* *Carpenter's Pension Fund v. Campa*, 100 S. Ct. 696 (1980), where the United States Supreme Court dismissed for want of a substantial federal question a case in which the retirement plan was joined under § 4361.2.

203. 29 U.S.C. § 1132(e) (1976) permits concurrent state and federal jurisdiction for suits by participants and beneficiaries.

204. 29 U.S.C. §§ 1131-1132 (1976).

205. 6 Cal. 3d 461, 492 P.2d 13, 99 Cal. Rptr. 325 (1972), *disapproved on other grounds in In re Marriage of Brown*, 15 Cal. 3d 838, 851 n.14, 544 P.2d 561, 569, 126 Cal. Rptr. 633, 641. See text accompanying notes 183-95 *supra*.

met. The tax consequences of such distributions are complex and highly speculative.

Division of Common Law Marital Property Retirement Benefits Between the Spouses

The division of common law marital property in a divorce is a taxable event.²⁰⁶ In common law jurisdictions, retirement benefits are owned by the employee spouse. Although there is no authority directly on point on the taxation of retirement benefits divided between the spouses in a divorce, the anticipated results may be derived from the rules developed to govern divisions of other marital property.²⁰⁷

If retirement benefits are divided between the spouses on divorce, the employee spouse in a noncommunity property jurisdiction may be deemed to have exchanged that portion of the retirement benefits awarded to the nonemployee spouse for the surrender of his or her marital property rights.²⁰⁸ If so, the amount realized from this "sale" would be considered to be the present value of the retirement benefits so awarded, because the value of the employee spouse's marital property rights is deemed to be equal to the value of what is transferred in exchange for the surrender of those rights.²⁰⁹ The employee's "basis" would be the amount of previously taxed contributions which, in the case of a noncontributory plan, would be zero.²¹⁰ The difference between the amount realized and the basis (which may very well equal the total present value of the benefit awarded to the nonemployee spouse) would be taxable gain.²¹¹ Because the taxpayer is transferring a right to future income, which when distributed would be ordinary income,²¹² any gain would be taxed at ordinary income rates.²¹³

206. *United States v. Davis*, 370 U.S. 65 (1962); *Carrieres v. Commissioner*, 64 T.C. 959, 964 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977). The result in *Davis* is criticized in Note, *Should Federal Income Tax Consequences of Divorce Depend on State Property Law?*, 49 S. CAL. L. REV. 1401 (1976).

207. For a greater discussion of the tax consequences of marital property divisions of divorce, see Anglea & Chomsky, *Property Divisions—Income Tax Aspects*, in TAX ASPECTS OF MARITAL DISSOLUTIONS: A BASIC GUIDE FOR GENERAL PRACTITIONERS 37 (1979); Glickfield, Rabinow & Schwartz, *Federal Income Tax Consequences of Marital Property Settlements*, U.S. CAL. 1974 TAX INST. 307; Sander & Gutman, *Divorce and Separation*, [1975] 95-3d TAX MNGM'T (BNA); Comment, *The Federal Income Tax Consequences of Property Settlements in Common Law States and Under the Uniform Marriage and Divorce Act: A Proposal*, 29 M.L. REV. 73 (1977).

208. See *United States v. Davis*, 370 U.S. 65 (1962).

209. *Id.* at 72.

210. See I.R.C. § 72(m).

211. I.R.C. § 1001(a).

212. Rev. Rul. 69-471, 1969-2 C.B. 10.

If the employee spouse is deemed to have sold his or her retirement benefits to the nonemployee spouse, the nonemployee spouse will have a basis in those benefits equal to their present value.²¹⁴ The non-employee spouse should be entitled to amortize that basis against the benefits as received.

This income tax result is supported by the analogous treatment of a widow who agrees to surrender her rights under community property law to one half of the community property in exchange for a life estate in the entire property, a so-called community property widow's election will. The widow is held to have purchased a life interest in her husband's share of the community and is permitted to amortize the purchase price against the income received.²¹⁵ The transfer of her marital rights is not a taxable event as to her.²¹⁶

The results outlined above may roughly approximate the tax result that would obtain if the entire retirement benefit had been awarded to the employee spouse, who then was taxed on each payment as received.²¹⁷ Nonetheless, the result is extremely harsh when the division results from a divorce. In this instance, the tax is computed on the entire taxable portion of the retirement benefit in one year, rather than as paid out over the distribution period. Because of the progressive rate structure, this results in a greater tax being paid on the same taxable income.²¹⁸ Moreover, the employee is not able to use the special tax on lump sum distributions²¹⁹ because there has been no distribution. In fact, even if there were a constructive distribution, the result would be the same because it would not be of the entire balance in the account and there would be no separation from service by the employee.²²⁰ Finally, the tax must be paid at a time when no cash has been generated by the sale.

If the employee spouse is not taxed at the time a marital property interest is awarded to the nonemployee spouse, the same tax treatment would be afforded the payment of the benefits to the nonemployee

213. The transferor spouse should be able to use income averaging under I.R.C. §§ 1301-1305, provided that the other requirements of those sections are met.

214. *Farid-Es-Sultaneh v. Commissioner*, 160 F.2d 812 (1947).

215. *Gist v. United States*, 423 F.2d 1118 (9th Cir. 1970); *Estate of Daisy F. Christ v. Commissioner*, 54 T.C. 493 (1970), *aff'd on other grounds*, 480 F.2d 171 (9th Cir. 1973).

216. Rev. Rul. 67-221, 1967-2 C.B. 63. See Mullock, *Divorce and Taxes: Rev. Rul. 67-221*, 23 U. MIAMI L. REV. 736 (1969).

217. See I.R.C. § 72(m).

218. I.R.C. § 1.

219. I.R.C. § 402(e).

220. I.R.C. § 402(e)(4)(A).

spouse. Consequently, the employee will be taxed in full on both his or her share of the benefit *and* the share transferred to the nonemployee spouse. Moreover, nothing would be deductible because the payments to the nonemployee spouse would not be alimony, but installment payments of marital property.²²¹ Of course, if the employee were taxed on the spouse's share of the benefit at the time of divorce, there would be no tax as a result of the distribution.²²²

Division of Community Property Interests in Retirement Benefits

As discussed previously, the preferred method of disposing of retirement benefits which are community property is to award them entirely to the employee spouse and to allocate to the nonemployee spouse other community assets of equal value.²²³ Alternatively, each spouse may be awarded a portion of each payment when it is distributed from the plan. In either event, if the community property is divided equally with reference to its fair market value, the division will be nontaxable.²²⁴ Other tax problems arise, however, when that benefit is community property.

Assignment of Income

A basic principle of tax law is that earned income is taxed to the person who earned it even when it has been validly assigned under state law.²²⁵ The doctrine of anticipatory assignment of income may be applied to an otherwise tax-free division of community property.²²⁶ If an anticipatory assignment of income has occurred, the assignor will be taxed when payment is made to the assignee.²²⁷

If community property is divided by awarding all retirement benefits to the employee spouse, the Internal Revenue Service has ruled that the nonemployee spouse may be deemed to have made an anticipatory

221. I.R.C. § 71(b); Rev. Rul. 69-471, 1969-2 C.B. 10.

222. These results probably also would apply to divisions of quasi-community property, although the tax attributes of such property have never been determined. See Anglea & Chomsky, *Property Divisions—Income Tax Aspects*, in TAX ASPECTS OF MARITAL DISSOLUTIONS: A BASIC GUIDE FOR GENERAL PRACTITIONERS 60-63 (1979). In addition, the results might apply to unequal divisions of community property, where one spouse is deemed to have sold his or her interest. See *Carrieres v. Commissioner*, 64 T.C. 959 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977).

223. See note 10 & accompanying text *supra*.

224. See *Carrieres v. Commissioner*, 64 T.C. 959 (1975), *aff'd*, 552 F.2d 1350 (9th Cir. 1977).

225. *Helvering v. Eubank*, 311 U.S. 122 (1940); *Lucas v. Earl*, 281 U.S. 111 (1930).

226. See *Johnson v. United States*, 135 F.2d 125 (9th Cir. 1943).

227. *Helvering v. Eubank*, 311 U.S. 122, 125 (1940).

assignment of income.²²⁸ Because retirement benefits are attributable to services rendered during marriage, they represent earned income which is owned equally by both spouses.²²⁹ Amounts contributed to a qualified trust or custodian account may not have been taxed previously to the employee.²³⁰ Therefore, when the entire benefit is awarded to the employee spouse upon dissolution, the nonemployee spouse may continue to be liable for the tax on his or her community property portion of the benefit as an anticipatory assignment of income. In that case, the taxable portion of the nonemployee spouse's interest in each benefit payment will be taxed to the nonemployee spouse at the time it is paid to the employee spouse. Such payments may occur long after the dissolution and may extend over many years, thereby requiring continued contact between the former spouses to apportion the tax liability relating to the benefit payments.

The fact that division of the community property is not a taxable event does not preclude application of the doctrine of assignment of income. In *Johnson v. United States*,²³¹ accounts receivable from the husband's law practice were assigned to him under a marital property agreement entered into prior to divorce. He claimed one half was taxable to his former spouse, even though the accounts were collected by the husband. The Ninth Circuit Court of Appeals agreed, holding that half of the accounts receivable, when collected, were not taxable to him but to the former wife, who had not been taxed on the community income prior to its award to the taxpayer.²³²

Despite the widespread application of the doctrine of anticipatory assignment, the relevance of *Johnson* and the line of cases following it²³³ to an award of retirement benefits caused by marital dissolution is unclear. These decisions, it is submitted, should not apply to a disposition of interests in retirement plans. When the property divided is

228. Private Letter Ruling 7952045 (Sept. 25, 1979). A private letter ruling may not be used or cited as precedent, I.R.C. § 6110(j)(3), but is ignored at one's peril.

229. See CAL. CIV. CODE § 5105 (West Supp. 1980); *Poe v. Seaborn*, 282 U.S. 101, 111 (1930).

230. I.R.C. §§ 219, 220, 404.

231. 135 F.2d 125 (9th Cir. 1943).

232. *Id.* at 130.

233. Cases following *Johnson* are *Crosby v. Commissioner*, 32 A.F.T.R. 1641 (9th Cir. 1943), *vacating* 46 B.T.A. 323 (1942) (salary for services rendered prior to a property settlement but paid after the settlement is taxable one half to each spouse); *Hubner v. Commissioner*, 28 T.C. 1150 (1957) (ex-spouse taxed on additional, distributable net income of husband's partnership in the year prior to the settlement agreement despite property settlement reserving to the wife a fixed dollar amount equal to one half of husband's capital interest in the partnership).

community property, there is no rationale for taxing the assignor. There is neither a tax avoidance incentive nor any other unconscionable motive in making the assignment which requires that the income be taxed to the assignor.²³⁴ In the usual assignment of income case, a high bracket taxpayer is trying to shift income to a low bracket taxpayer, such as a child. By contrast, in the case of retirement benefits, because of the progressive tax rate structure, taxing the entire benefit to the recipient (the putative assignee) may well result in a higher tax being paid than if each spouse were taxed on a portion.

In addition, the Internal Revenue Code contemplates that the community property laws will be disregarded and the entire benefit treated as if owned by the employee spouse when taxing the ordinary income portion of lump sum distributions.²³⁵ This provision should, by analogy, be extended to the present situation. For these reasons, the employee spouse who has been awarded the entire retirement benefit should be taxed on it when received. As a practical matter, that is undoubtedly how spouses treat retirement benefits so divided.²³⁶

Identification of the Proper Taxpayer

When community property retirement benefits have been divided between the spouses, the plan administrator often will pay the entire benefit to the employee spouse who in turn will pay a share to the non-employee spouse. In some circumstances, this may be the only way in which benefits may be distributed.²³⁷ In such cases, how is the benefit to be taxed as between the spouses? Because the employee spouse is acting merely as a conduit for the funds, the correct approach would be to treat the employee as a nominee or agent of the nonemployee spouse.²³⁸ Under this analysis, the employee would not be taxed on the

234. See *Hempt Bros. v. United States*, 490 F.2d 1172 (3d Cir.) cert. denied, 419 U.S. 826 (1974) (the assignment of income doctrine is not applied when a partnership assigned accounts receivable to corporation in exchange for stock as part of tax-free incorporation of the partnership).

235. I.R.C. § 402(e)(4)(G).

236. The employee spouse to whom the interest has been awarded could assume liability for all taxes payable on the nonemployee spouse's share. This could create further tax problems. See *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). For further discussion of this issue, see Anglea & Chomsky, *Property Divisions—Income Tax Aspects*, in *TAX ASPECTS OF MARITAL DISSOLUTIONS: A BASIC GUIDE FOR GENERAL PRACTITIONERS* 37 (1979).

237. See, e.g., *In re Marriage of Fithian*, 10 Cal. 3d 592, 517 P.2d 449, 111 Cal. Rptr. 369 (1974).

238. See Rev. Rul. 58-220, 1958-1 C.B. 26. The employee spouse should attach a schedule to his or her income tax returns showing the receipt of benefits, the amount paid to the former spouse, and, if there has been tax withheld by the payor, how it is to be divided

portion of the benefits remitted to the nonemployee spouse, but the latter would be required to include such benefits in gross income.

If the employee spouse fails to pay over the amounts after a court order or settlement requiring payment, he or she has in effect converted them and should be taxed on the amounts so converted.²³⁹ If subsequently the payments are made to the nonemployee spouse, he or she should be entitled to a corresponding deduction in the year of payment.²⁴⁰ The nonemployee spouse should not be taxed on such amounts unless and until they are in fact paid over.²⁴¹

Taxation of the Nonemployee Spouse on Distributions of the Community Property Interest

A detailed discussion of the taxation of distributions from qualified retirement plans is beyond the scope of this Article.²⁴² In general, however, the taxation of retirement benefits distributed to a participant or beneficiary is quite favorable. Benefits will not be taxed until they actually are distributed, even though fully vested.²⁴³ If the distribution

between the spouses. The plan apparently is required to report the benefits as if paid to the employee spouse. Private Letter Ruling 7952045 (Sept. 25, 1979).

239. See *James v. United States*, 366 U.S. 213 (1961).

240. *Id.* at 220.

241. Cf. *Alsop v. Commissioner*, 290 F.2d 726 (2d Cir. 1961) (agent failed to report or deliver royalties to taxpayer).

242. For a discussion of taxation of distributions, see M. CANAN, *QUALIFIED RETIREMENT PLANS* (1977); see also Lamon & Lee, *Pre-Retirement Qualified Plan Pay-outs under ERISA*, 9 CUM. L. REV. 83 (1978).

243. I.R.C. § 402(a). I.R.C. § 72(m) provides that if the benefit is funded only by employer contributions or contributions which were deductible when made, under I.R.C. §§ 219, 220 & 404 the full amount of each payment will be taxable to the employee when received. If both employee and employer contributions have been made, then the taxable portion of the retirement benefits will be the amount in excess of contributions made by the employee. Usually, the taxable portion of each benefit payment will be determined under the exclusion ratio method of I.R.C. § 72(b) whereby the expected return of the benefit, computed actuarially, is compared to the employee contributions. The ratio thus derived is applied to each payment to determine the nontaxable or excluded portion which represents a return of the employee's contributions.

For example, a male age 65, who has contributed \$9,000 of after-tax dollars to the trust, retires and is entitled to receive \$200 a month for life. His retirement benefit or "expected return" is \$2,400 per year \times 15.0 years (his life expectancy under Treas. Reg. § 1.72-9 Table A (1957)) or \$36,000. His contribution or "investment in the contract" is \$9,000. I.R.C. § 72(c)(1) & (f). The exclusion ratio will be $\frac{\$9,000}{\$36,000}$ or .25. Therefore, \$600 of his \$2,400 pension each year (.25 \times \$2,400) will not be taxable to him.

If the same employee had contributed only \$6,000, he would be taxed under the "three year recovery method." I.R.C. § 72(d)(1). Under this method, if the aggregate amount receivable as benefits in the first three years equals or exceeds the employee's contributions, then the benefit payments will first be treated as a return of contributions. In our example,

qualifies as a lump sum distribution,²⁴⁴ it will be subject to a "separate tax" resulting in the application of even more favorable tax rates.²⁴⁵ Taxation of a lump sum may be deferred by either the employee or the surviving spouse²⁴⁶ by rolling it over in whole or in part into an IRA or into another qualified plan.²⁴⁷ Moreover, amounts attributable to employer contributions will be excluded from the gross estate of the employee if they are paid on account of his or her death to a distributee other than the employee's estate or executor.²⁴⁸ A nonemployee spouse who predeceases the employee is entitled to a comparable exclusion from his or her gross estate of the community property interest.²⁴⁹

Which, if any, of these rules should be applicable to the nonemployee spouse whose community property interest in the benefits is severed upon divorce? The nonemployee spouse should not be taxed on an interest until it is distributed from the plan.²⁵⁰ If the interest is distributed in one payment, the payment would probably not qualify for lump sum treatment under the conditions specified in Internal Revenue Code section 402(e)(4)²⁵¹ and probably would not be the "balance to the credit" of the employee but only his or her community property portion thereof.²⁵²

If a lump sum distribution is made at the same time a distribution is made to the employee, then the nonemployee spouse should be entitled to have the pre-1974 portion of the distribution taxed at favorable

nothing would be taxed in the first two years, and in the third year \$1,200 (\$6,000 in total employee contributions less the \$4,800 received in years one and two) would not be taxable. Thereafter, the full amount of each payment would be taxable.

244. A lump sum distribution is one payable to the distributee in one taxable year on account of death, disability, separation from service, or after attainment of age 59½. I.R.C. § 402(e)(4).

245. The lump sum distribution will be divided into two parts. The taxable portion, *i.e.*, the excess over employee contributions, attributable to participation in the plan prior to January 1, 1974 will receive long term capital gain treatment. I.R.C. § 402(a)(2). The taxable portion attributable to post-1973 participation will be subject to a "separate tax" under which the distribution is taxed as if it were the only income received by the taxpayer, averaged over a ten year period. I.R.C. § 402(e).

246. I.R.C. § 402(a)(7), *added by* Revenue Act of 1978, Pub. L. No. 95-600, § 157(g), 92 Stat. 2806-2807 (1978).

247. I.R.C. § 402(a)(5), (6)(C) & (D). The rules regarding rollovers are technical and complex. For a description of such rollovers, see IRS, PUBLICATION 590, TAX INFORMATION ON INDIVIDUAL RETIREMENT SAVINGS PROGRAMS (1979).

248. I.R.C. § 2039(c).

249. I.R.C. § 2039(d).

250. The nonemployee spouse also should not be taxed if the benefit is put into an Individual Retirement Account. See notes 135-37 & accompanying text *supra*.

251. I.R.C. § 402(e)(4).

252. I.R.C. § 402(e)(4)(A).

capital gains rates under section 402(a)(2).²⁵³ The nonemployee spouse could not, however, use the "separate tax" provided by that section on the ordinary income portion of the distribution. The statute does not permit married spouses in community property states to use the separate tax on each spouse's one half of the post-1973 lump sum distribution.²⁵⁴ A similar result should obtain if the marriage is dissolved prior to distribution, so that the nonemployee spouse would be taxed at ordinary income rates on the post-1973 lump sum distribution.

A nonemployee spouse probably would not be eligible to roll over a lump sum distribution if it is made after divorce; after that time he or she is not the surviving spouse.²⁵⁵ Therefore, the nonemployee spouse would not qualify under Internal Revenue Code sections 402(a)(5) and 402(a)(7) for a tax-deferred rollover. If a qualified lump sum distribution is made to the employee prior to the divorce, the employee may take advantage of the rollover rules to put the benefits into an IRA.²⁵⁶ The IRA then may be divided between the spouses tax free.²⁵⁷ The "separate tax" will not be available for later distributions from the IRA for either spouse, even if the distribution is in the form of a lump sum.²⁵⁸

Legislative Proposals for Taxing Retirement Benefits on Divorce

Disposition of retirement benefits upon divorce requires tax certainty. Property settlement agreements involving retirement benefits are entered into in part with the expectation that certain tax results will follow. The present state of the law, however, is intolerably uncertain. The tax results surrounding disposition of retirement benefits are at best speculative and, at worst, to the extent they can be deduced, harsh and unfair. In noncommunity property jurisdictions, the prospect of a division of benefits upon divorce being treated as a taxable sale produces results which are unduly harsh to the employee spouse, who will be taxed on the full benefit, and unduly lenient to the nonemployee spouse, who may not be taxed at all. In community property states, the potential assignment of income issue is a troublesome problem. In either case, the different tax consequences that flow from the receipt of

253. I.R.C. § 402(a)(2). See H.R. REP. NO. 93-807, 93d Cong., 2d Sess. 152 n.5, *reprinted in* [1974] U.S. CODE CONG. & AD. NEWS 4670, 4817.

254. I.R.C. § 402(e)(4)(G).

255. See text accompanying notes 159-62 *supra*.

256. I.R.C. § 402(a)(5).

257. I.R.C. § 408(d)(5).

258. I.R.C. § 408(d).

benefits as a divorced spouse rather than as a surviving spouse seem unwarranted.

Once again, ERISA contains the model which can be adapted to solve these problems. The present nontaxable transfer of an IRA on divorce should be extended to cover the transfer of all retirement benefits upon divorce. Correspondingly, each spouse should be treated as having made one half of the employee contributions, if any, to the plan²⁵⁹ and should be taxed individually on the benefits when distributed under Internal Revenue Code sections 72 and 402. If benefits are awarded entirely to one spouse, assignment of income doctrines should not apply.

Of course, every tax statute must have an exception; here, neither spouse should be able to take advantage of the separate tax on lump sum distributions individually.²⁶⁰ Congress has specified that the tax was to be computed in disregard of community property laws for good reason. There is already a significant tax advantage in using the separate tax on the taxable portion of the lump sum distribution by one spouse. That advantage would be increased unconscionably if each spouse were to use the special tax on one half of the distribution, assuming it met the other requirements. Therefore, if the spouses are going to avail themselves of the separate tax, it should be computed with regard to the entire lump sum distribution and each spouse should be individually liable for the tax on his or her respective share.

In addition, each spouse should be able to roll over that portion of the retirement benefit distributed in the form of a single payment. If the distribution is made to the nonemployee spouse while the employee is still employed, a rollover should be mandatory.²⁶¹ If a single payment is made to either spouse when benefits have become payable under the plan, a rollover should be elective as to each spouse individually.²⁶² A former spouse need not be treated differently from a surviving spouse in this respect.

Conclusion

Accommodation of the nonemployee spouse's community property interest in retirement benefits should not be difficult. The majority

259. This would correspond to retention of the marital basis by the spouse awarded the asset in property divided tax free in a divorce. *See* Rev. Rul. 76-83, 1976-1 C.B. 1213.

260. *See* note 236 *supra*.

261. *See* notes 135-37 & accompanying text *supra*.

262. This could be accomplished by amending I.R.C. § 402(a)(7) to include former spouses.

of the complexities and costs generated by the issue have arisen solely because the law is unsettled. Once a former spouse's interest in a plan arising out of the marital relationship is clarified, attention may be focused on accommodating that interest in the simplest and fairest way possible. Filing the state court decree with the plan as a condition of payment, authorization of the plan fiduciary to distribute the interest to the nonemployee spouse independently of distribution to the employee spouse, and use of mandatory individual retirement accounts would preserve the retirement goals of ERISA as to the nonemployee spouse's benefit, at little or no additional cost to the plan. Tax-free division of retirement benefits on divorce, with the nonemployee spouse taxed in the same manner as the employee, also should be provided for. In this way, disposition of retirement benefits on divorce can be treated in an ordinary, routine manner instead of as the troublesome and often insoluble problem it is today.

